

MARKETING PRINCIPLES
Organization and Policies

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BY

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REVISED EDITION

McGRAW-HILL BOOK COMPANY, Inc.

NEW YORK AND LONDON

FIRST PUBLISHED AUGUST 1923
REPRINTED 1935, 1936

McGraw-Hill Book Company, Inc.

PRINTED IN THE UNITED STATES OF AMERICA

THE MAPLE PRESS COMPANY, YORK, PA.

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PART I
THE NATURE OF MARKETING

CHAPTER I

SOME SIGNIFICANT ASPECTS OF MARKETING

Purpose of this chapter: To indicate the importance of the marketing process in our economic system; to present a brief summary of the evolution of our marketing system; and to survey the general conditions affecting marketing policies, organizations, and practices.

The Genesis of Marketing.—Marketing as an economic activity has its genesis in the highly developed specialization of labor and of processes, which is, perhaps, the outstanding characteristic feature of twentieth century industrial society. Forty per cent of the total population of the United States, in normal times, is gainfully employed. Forty-seven per cent, approximately, of this group is engaged in supplying the entire population with services of various kinds, while the other 53 per cent is producing, in many varieties of forms and qualities, different articles of merchandise used by our people and by foreigners. Approximately 60 per cent of those producing tangible goods are engaged in making available *consumption* goods, *i.e.*, merchandise used by the ultimate consumer in his everyday life. The other 40 per cent are engaged in producing *durable* goods, *i.e.*, goods that do not disappear immediately with use but are used repeatedly over an extended period of time.

The high degree of specialization, which is necessary to meet modern needs and to bring about low cost of production relative to non-specialized methods of production, develops a correspondingly high degree of interdependence among individuals, between individuals and business enterprises, between business enterprises and industries; among individuals, governmental units, business enterprises, and industries; and among nations and geographical sections of the world.¹ Each of these units, therefore, finds it necessary to produce a surplus above its own needs in order to have something to exchange for needed goods and services

¹ In 1929 there were 210,959 manufacturing establishments in the United States; 30,597 establishments engaged in construction. The estimated value of actual goods and services produced in 1929 was approximately \$81,000,000,000. The 1934 *Census of American Business* reported, for 1933, 164,101 wholesale establishments, 1,526,119 retail establishments, and 502,416 service establishments. There were, in 1929, 3,073 counties; 13,433 incorporated places having a population of less than 2,500; 64,387 townships and other minor civil divisions; and 93 cities of more than 100,000 population. The population of the United States, in 1929, was estimated at 122,775,046 persons, comprising approximately 30,000,000 families. The population in 1935 was 127,521,000 people.

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produced by other units. When each unit exchanges the results of its efforts directly for the desired quantities and qualities of other units, we have a barter system. Experience has taught society that the barter plan, normally, is not suited to a specialized method of production based on private property. Consequently, the marketing system was evolved. Merchandise and services under this plan are exchanged by the various units for money,¹ and then the money is exchanged for the desired goods and services. This practice, however, emphasizes the problems of the distribution of income, of pricing, and of purchasing power. A need was felt for some form of organization whereby the producing units could dispose of their surpluses and supply their wants, and those of the non-producing portion of the population, as to kind, quantity, and quality of economic goods. The economic process which accomplishes this exchange of goods for money and money for goods may be called marketing. It is through the marketing process with its organizations, policies, and practices that the forces of demand and of supply act and react upon each other. It is through the marketing process that the millions of individual consumers and the tens of thousands of corporations express their wants for goods and services and supply their needs. The marketing process generates the organizing force which coordinates and ties together the thousands of widely scattered specialized producing units into our present industrial society.

Current Criticism.—Our marketing organizations, methods, and practices have been severely criticized during the last decade. The charge has been made repeatedly that there are greater wastes in marketing than in other forms of business activity. Before intelligent action can be taken toward bringing about a more efficient marketing system it is necessary to secure a clear understanding of the present situation.

Why is the subject of marketing receiving so much attention at present? What groups of people are primarily interested in solving the difficulties met in buying and selling goods and services? Are these difficulties more formidable now than formerly? What are the necessary services to be performed during the marketing process? What different types of organizations have been developed to perform these services? How effective have these organizations proved themselves to be? What methods and practices are the organizations using in the performance of the services? Are these methods and practices the most effective possible under the present situation? How can we determine the degree of effectiveness with which the services are performed? What are the major marketing problems? What of the future? Should the situation be changed? If so, how, and to what extent?

¹ The term money is used in the broad sense to include bank deposits subject to check.

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These questions, along with others, are presented for discussion in the various sections of this book.

The Meaning of Certain Marketing Terms.—Marketing may be thought of as that phase of business activity through which human wants are satisfied by the exchange of goods and services, on the one hand, for some valuable consideration—usually money or its equivalent—on the other. The transaction always involves the transfer of ownership and usually, but not necessarily, a transfer of possession and the transportation of the goods. Marketing is a means whereby the producer or seller disposes of his surplus goods, and the consumer or buyer supplies his deficiency. Thus the farmer sells his surplus wheat to the miller, who in turn sells flour to the baker, who sells bread and cakes to the housewife. The baker, obviously, has to buy such other ingredients as sugar, milk, eggs, and fats, and to provide himself with fuel, light, and equipment from surplus producers before he can finally produce the breads and cakes which he sells to the housewife. She, on the other hand, must possess purchasing power in the form of money, credit, or produce before she can buy the baker's wares.

The term "marketing," as used in this book, comprises both buying and selling activities. It is obvious that there can not be a sale unless some one buys and vice versa. The marketing process, consequently, has two distinct yet complementary parts.

Buying comprises all those activities involved in finding a suitable source of supply, selecting the desired quantity, quality, grade, style, and size, and coming to an agreement with reference to the price, delivery date, and other conditions.

Selling, on the other hand, comprises all those personal and impersonal activities involved in finding, securing, and developing a demand for a given product or service, and in consummating the sale of it. The major divisions of the selling process are advertising and salesmanship.

Merchandising is that part of the marketing process which has to do with the determination of *what* to produce, add to or take from a line of merchandise; the discovery and development of new uses for old products as well as new products for old uses; and the pricing of the product. It is an equalizing or adjusting factor tending to coordinate supply and demand. This particular aspect of marketing is receiving more attention from business men than formerly because of many serious losses, due to unexpected changes in demand and in products, that upset marketing methods, programs, and production schedules.¹

¹ For example, consider the effect of the development of alternating-current radio sets upon the demand for battery sets; the automobile and tractor upon the demand for harness, buggies, horses, and corn; new models upon old models; electrical refrigeration upon ice and ice-making machinery.

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Advertising in its many forms is that part of the selling activity which aids in buying and selling, usually by presenting a non-personal message simultaneously to a large group of potential customers. The more commonly used mediums for conveying the message on a mass-production scale are newspapers, periodicals of diverse kinds, car cards, poster panels, the manifold forms of mail communication, the radio, talking pictures, and various kinds of outdoor media.

Salesmanship is that division of the selling activity by which the seller or his agent, in the presence of the prospective buyer, attempts to bring about a mutually satisfactory exchange of goods or services for a money consideration.¹ It is the function of the salesman to determine the want or need of the prospective buyer and then bring him to a realization of his need if he is not already conscious of it; to convince him that the product will satisfactorily meet his need; and, finally, to secure the desired action on the part of the prospect in such a manner that he will become a satisfied customer or buyer.

Marketing is facilitated by business enterprises engaged in furnishing such services as transportation, storage, grading, inspection, credit, insurance, education, and printing. Other business organizations provide a reading public, meeting places, and marketing information. These facilitating agencies do not, however, in the ordinary course of business take title to goods or negotiate purchases and sales.

Growing Public Interest in Marketing.—The number of people engaged in the field of marketing increased, from 1890 to 1930, about three times. This rate approximated the rate of the growth in the urban population. The increase from 1910 to 1930 was approximately 70 per cent. The value and variety of commodities sold through mercantile institutions increased greatly during the period. Many new commodities—electric lights, telephones, gas and electric ranges, automobiles, gasoline, radios, electric refrigerators, more ready-made clothing, canned goods, many forms of power machinery, and a large number of substitutes for wood, used in the construction industry—were developed; changed habits and modes of living appeared, and more reliable commodity information for the consumer was made available. All of these changes

¹ The Committee on Definitions of the National Association of Teachers of Marketing suggests the following definitions for *advertising*, *publicity*, and *personal salesmanship*. *Advertising* is any paid form of non-personal presentation of goods, services, or ideas to a group—such presentation being openly sponsored by the advertiser. *Publicity* is any form of non-personal presentation of goods, services, or ideas to a group. Such presentation may or may not be sponsored openly by the one responsible for it and it may or may not be paid for. *Personal salesmanship* is an informal, personal, and oral presentation usually to an individual prospect for the purpose of selling.

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made it necessary to increase the number of people in the field of marketing.¹

The growing complexity of our economic life develops new and greater difficulties for the consumer in his attempts to satisfy his wants, as well as for the producer in his attempts to determine what the consumer desires and to present his merchandise and services in an acceptable manner. The successful solution of these difficulties requires a more or less accurate knowledge of these problems, their sources and characteristics, what has been done, and what can be done about them. These changed conditions have greatly increased the amount of the national income that goes to pay for the costs involved in furnishing the desired services and merchandise. The costs of marketing all goods in 1933 were equal, approximately, to one-third of the national income for that year. The marketing costs of some products equal one-half the price paid by the consumer and in a few instances—e.g., fruits and vegetables—may equal two or three times the price received by the producer, or as much as 75 per cent of the price paid by the consumer.

The thoughtful consideration given the subject of marketing by bankers, manufacturers, politicians, educators, and editorial writers is another indication of the importance attached to problems of buying and selling. Newspapers and periodicals devote much space to market news, comment, and discussion which is eagerly read by producers, merchants, and consumers. An examination of the card index of any large public library reveals scores of books that discuss marketing problems. This list, moreover, is increasing rapidly. A survey of the *Readers' Guide to Periodical Literature* and of the *Industrial Arts Index* for five years back will reward the investigator with a bewildering array of titles of articles written on the various aspects of buying and selling. If we examine the programs of the meetings of different business associations and organizations, we find a large amount of time given over to the study of problems of marketing. Many of these groups have found it advisable to appoint and finance committees to make special studies. Marketing has grown from a relatively simple process to one that affects the welfare of all classes, and it presents problems so complex and difficult that they challenge the best minds of the nation.

¹ According to estimates by Galbraith and Black, published in the *Quarterly Journal of Economics*, May, 1935, the value added by marketing to products in 1929 was \$24,380,000,000 compared with \$28,250,000,000 added by manufacturing; marketing added \$13,369,000,000 to the national income, or 16 per cent, while manufacturing added \$17,350,000,000, or 21 per cent of the national income. The total number of people employed in marketing activities, not including transportation and communication, was 8,100,000, or 16.6 per cent of all gainful workers; manufacturing accounted for 27.4 per cent.

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Evolution of Marketing Organization and Practice.—The problems of marketing are being attacked by three different groups, each having in mind the conditions that are causing it the greatest concern. The *producer*, for instance, finds his major problems centering around the determination of *what* to produce that will satisfy the fancy of the buyers and users, and what methods to use in getting his goods to the customer. During the depression the widespread practice of cut-throat competition developed into a major problem for this group. The *merchant*, on the other hand, sees his major problem centering around *securing* what the consumer wishes, and having it ready for him *when* he wants it and at *the price* he is willing to pay. The wholesaler and retailer are concerned, primarily, with competition, sources of supply, terms of purchase, style, service, and the changing whims of the populace. The third group, the *consumer*, considers the problem of marketing largely from the point of view of price, service, and quality. In a *buyers' market* the consumer does not recognize many serious difficulties, but in a *sellers' market*, such as existed during 1917 to 1920, he becomes super-sensitive to the difficulties he encounters in securing *what* he wants, *when* and *where* he wants it, and at the *price* he considers fair or just.

The producer, the merchant, and the consumer are learning that they have a common objective in working for the establishment of policies, the formation of organizations, and the development of methods and practices that will enable goods of the desired amount and quality to flow from the producer to the consumer through the channels that provide the lowest cost compatible with the quality and quantity of service rendered.

Much of the so-called New Deal legislation was designed to affect marketing organization, policies, and practices. The codes, the Agricultural Adjustment Administration, and the laws concerning the operation of security and commodity exchanges represent the attempts of organized society to reconcile the divergent interests of these groups and to define and to protect the rights of each.

Basic Factors.—The roots of the problems in marketing, as well as so many of our other business difficulties, spring from the constantly changing character of our economic and social institutions. Our present complex and involved economic organization may be more easily understood, perhaps, if we review, briefly, our economic development. This will show how the evolution from a simple rural community to a highly industrialized state has transformed the process of buying and selling into the outstanding problem of modern business.

Conditions Prior to the Industrial Revolution.—It is not necessary, for our purpose, to survey the economic organization of ancient Assyria, Babylonia, Egypt, Greece, and Rome, even though we might find such a

study very interesting and valuable. A study of the rural, town, and commercial organizations of medieval England will give an adequate picture of a relatively simple economic structure whence can be traced the more important changes it has undergone in the years following.

Economic Organization of Medieval Rural England.—Nine-tenths of the people of medieval England lived in the country and secured their living from tilling the soil. The country was divided into a number of large estates, frequently with large expanses of forest, waste, and uninhabited lands separating the boundaries of the estates. Title to all land was held by the king who let it out to his lords. The people lived in villages and farmed the surrounding land. They did not own the land or tools and did not work for a money wage. Instead of having free land-owning and renting farmers, as is the case in the United States, there was a strict class system made up of lords, freemen, villeins, and cotters. The status of each class was rigidly fixed by custom. The methods of planting, cultivating, and harvesting crops likewise were controlled by custom. The group labored as a community with little thought of experimentation, crop rotation, planning, or the exercise of individual initiative. The method used was the open-field system based upon the cooperative work of a number of land holders who held their land as serfs from an overlord. The purpose of agricultural production in medieval England was for local consumption and self-subsistence in contrast to modern production for the market. The manor was isolated and self-sustaining, as opposed to the interdependence of the modern farmer. There was no market for agricultural goods—therefore no value in exchange. There was no price level, as payments were made in kind. There was little private property, specialization, competition, money, or freedom of contract. Toward the latter part of the Middle Ages, when towns began to develop, grain and live stock in comparatively large quantities were regularly sent to markets by the lords and bailiffs of the manors.¹

Economic Organization of the Medieval English Town.—Town life was quite simple in the earlier period of the Middle Ages. Some villages grew into towns as time went on. This was especially true if they happened to be located on a river that furnished a means of transportation or where there was a ford or mill. In other instances, towns grew up around fortified places, in court villages, and at tax-collection points. These towns played an important role in the economic development of the Middle Ages even though only a small percentage of the population lived in them. There grew up in the towns new classes of people, the

¹ For a more complete discussion of the subject, cf. E. P. Cheyney, *Industrial and Social History of England*, Chap. II, and F. W. Tickner, *Social and Industrial History of England*, Chaps. II, III.

traders and craftsmen, who sold goods to each other and to outsiders. Thus marketing, in a simple form, appeared in a definite manner. Buying and selling, however, were under the control of merchant guilds which exercised a monopolistic power over all trade. The guild merchant determined who could buy and sell, and the conditions under which trading was transacted. Members of the guild were favored, while outsiders were discriminated against. The interests of the consumers were protected in that the members of the guilds were required to give full weight and good measure; forestalling, engrossing, and regrating were forbidden.

Although the guild merchants, in the earlier part of the medieval period, exercised a powerful influence over trading and manufacturing, a time came when the craft guilds overshadowed and, in many instances, completely displaced them. A craft guild was made up of members of a single craft. As new crafts of industry arose, more and more craft guilds appeared. Membership, quality of work, condition of employment, methods of trading, and the like were carefully regulated by these guilds. The craft guild form of production was known as the "handicraft" system. Under this system we find a small-scale industry controlled by local monopolistic societies. Instead of manufacturing for an impersonal general market, as is typical of modern industry, production was largely to order; consequently, there were few middlemen. There was no power machinery; processes of manufacturing were few and simple. It was a tool industry carried on in small quarters with apprentices and a few free laborers working for a wage. This form of life apparently developed ideals of liberty, honesty, fairness, and the dignity of labor. Here business relations were based on contract, money payments, and specialization. The town, as it developed, tended to aid in the breaking down of the isolation, independence, and self-sufficiency of medieval rural England. It also furnished a limited market for surplus agricultural products and a source of some goods needed by the agricultural classes.¹

The Commercial Organization of Medieval England.—The handicraft system of production was followed by the domestic system. While the technique of manufacturing was little different in the two systems, the chief change was in the control and direction of industry. Under the domestic system the craftsman became a wage earner who was supplied with tools and raw materials by a merchant who told him what, how, and when to produce. This merchant-manufacturer did none of the manufacturing himself but supervised it and assumed the risks of production and marketing. The domestic system was common in all lines of industry by the early part of the eighteenth century and continued until it was

¹ Cf. CHETNEY, *op. cit.*, Chap. III; Tickner, *op. cit.*, Chaps. IV-VI.

displaced by the factory system, which came with the so-called Industrial Revolution.

Marketing organization, methods, and practices during this period were crude. In fact, buying and selling were carried on under great handicaps. There were few roads and these were in poor condition, often infested by robbers. In some sections high tolls and taxes were assessed against the goods and travelers that passed. Commerce felt the need of a strong centralized government that could furnish protection and improve roads, rivers, and harbors. There were no banks and no uniform system of currency. Few people could read and write, so there were no newspapers and magazines; no means of communication by telephone, telegraph, cable, and wireless, such as we now have, were available; neither was there a uniform system of weights and measures.

Merchandise was usually sold by "merchants, peddlers, and chapmen." Goods were offered for sale at fairs and markets and in shops. Fairs were held at different intervals, sometimes only once a year. They usually served as an agency for wholesale marketing. Foreign merchants brought their goods to the fairs and bought goods to be taken abroad. Local and native merchants also used the fair as a place where buying and selling could be satisfactorily carried on. A considerable volume of retailing, however, was done at these meetings. Since the fair drew buyers and sellers from great distances, it was in reality a national institution; while a market, although authorized by a grant from the king, as was the case with the fair, was usually of only local importance. Markets were open, usually, only one or two days a week. The time of opening and closing the market was closely regulated so that no one seller could secure an advantage over another. Shops began, perhaps, as stalls in the market place and finally developed into sheds or display shelves attached to the front of the craftsman's house. There were few shops in medieval England outside London.

The tradesman of this period was not nearly so highly specialized as the twentieth century merchant. He bought and sold a wide variety of goods; furnished his own means of transportation; arranged for his own protection from robbers, fire, shipwreck, and the like; secured what market information he could; assumed directly the market risks; and performed the functions of advertising and selling.

Modern Industrial and Commercial Development.—By 1750 important changes had taken place and others came on rapidly. The development of the steam engine, power machinery, the factory, and rather minute division of operations ushered in the first stages of the Industrial Revolution. This gave rise to new industries; new districts became prosperous; cities with large industrial populations grew up; a new capitalistic class developed. There was a greater need for transportation, storage,

banking, and insurance services. New professional, commercial, and trade classes became prominent. The characteristic features of this period were large-scale standardized mass production, according to design, for a world-wide impersonal market; goods and services exchanged for money, which in turn was distributed among laborers, managers, landlords, capitalists, and service groups, who exchanged it for goods and services to meet their needs and wants.

It is not necessary, for our purpose, to trace in detail the causes and results of the many individual changes that took place during the nineteenth century. Our purpose will be served if we consider briefly some of the recent industrial changes that have affected marketing organizations, policies, and practices.

The changes that played such a great part in determining the marketing problems of today were not so much changes of *kind* as changes in *degree*. The major economic structures are of the same kind as those in existence at the beginning of the present century, but the economic organization is developing much greater force because of the increase in the speed and the breadth of its operation.¹ The depression of the 1930's, however, forced many changes in policies and practices of economic, social, and political organizations. Production and marketing were greatly affected by the breakdown of purchasing power of the masses, collapse of the financial structure of the country, and the disruption of the normal flow of foreign and domestic commerce. The tremendous expansion in production facilities during the ten-year period 1919-1929, the over-development of credit-creating agencies on both a national and an international scale, and the world-wide exuberant optimism of the period created apparently just the correct situation, when combined with the results of the World War, to produce a world depression of the first magnitude.

Some order out of the chaotic mass of difficulties encountered in marketing goods and services may be secured by classifying, on the basis of their source, the problems that have arisen. They may be conveniently grouped under four major classifications: (1) those problems that have their source in the changing conditions connected with the character of the product and the methods of production; (2) the problems that arise out of the ever-changing character of the market and the demand for merchandise and services. (3) There is a third set of problems that originate in the changes taking place in the marketing structure itself and in the methods employed. (4) Since 1930, governmental action,

¹ For an excellent comprehensive survey covering the period 1920-1928, see the Report of the President's Committee on Unemployment, *Recent Economic Changes in the United States*, Vols. I, II.

both federal and state, has greatly influenced marketing organisation, policies, and practices.

Characteristics of the Methods of Production and of the Products.—During the last twenty years great changes were made in the methods and scale of production; new inventions displaced old products, while the uses of some old products were greatly extended. The use of power and machinery was greatly increased. Following the close of the World War, some producers found themselves with excess capacity; consequently, they were forced to devise ways and means of stimulating demand for the goods they were equipped to manufacture. Improved methods of sales promotion—advertising, salesmanship, installment selling, prompt and immediate delivery, and other forms of service—were emphasized along with improvements in production designed to reduce costs. New types of products and improved models of old products were constructed for the purpose of stimulating sales. Many of the newer products, such as the automobile, radio, the talkies, rayon, electrical appliances, and the airplane, had far-reaching effects upon other industries. The advent of the closed-model automobile, for example, gave a great impetus to the glass, upholstery, and paint industries and intensified the marketing problems of the textile and clothing manufacturers. The automobile is responsible for the rapid growth in the production of rubber, oil, and cement. The extent to which the automobile has affected our economic life is indicated by the estimate that 10 per cent of the gainfully employed workers is employed either directly or indirectly in the automotive industry and that 15 per cent of total taxes is paid for the privilege of owning and operating motor vehicles. Agriculture as an industry is still suffering from over-production. The condition of over-production exists largely as a result of over-extension during the war period, the introduction of power machinery, and the decline in foreign demand since 1920. With the decline of agricultural prices, these producers reduced their purchases of manufactured goods, which promoted unemployment in the cities. This condition reduced purchasing power and caused sales to decline still more, thus intensifying the effects of the depression. Under the leadership of the A.A.A., however, supplemented by the drought of 1934, the huge surpluses accumulated during the preceding years were eliminated in 1935; purchasing power expanded owing to higher prices and benefit payments.

The following figures serve to illustrate some of the tremendous changes that have taken place. The value of all goods available for trade, valued at point of production or import, in 1929, was in excess of \$97,000,000,000. The value of the products of all manufacturers was approximately \$70,000,000,000. Gross farm income from crops and live stock in 1929 amounted to \$11,918,000,000; mine and quarry products

added approximately \$4,750,000,000; forest products and the fishing industry produced \$3,250,000,000 worth of commercial goods. In order to meet our 1929 demand we were forced to supplement the domestic supply by importing approximately \$4,333,000,000 worth of goods.¹ We were able to sell to foreign countries more than \$5,000,000,000 worth, or approximately 5¼ per cent of our total domestic production.

The degree to which the depression forced sharp reductions in all our productive activities is indicated by the following information.² Wholesale trade declined from \$69,000,000,000, in 1929, to \$32,000,000,000, in 1933. Retail sales declined from approximately \$49,000,000,000 to \$25,000,000,000. The value of industrial products declined from approximately \$70,500,000,000, in 1929, to \$32,000,000,000, in 1933. The net income reported on individual income-tax returns declined from \$24,800,000,000, in 1929, to \$10,800,000,000, in 1933. The national income declined from approximately \$83,000,000,000, in 1929, to \$38,333,333,000, in 1932, and then rose to more than \$55,000,000,000, in 1934.³ While these figures represent the all-time peak and perhaps the all-time lows for the United States, they indicate the importance of the marketing process in our economic life. A vast and complicated marketing machine is obviously necessary to provide means for distributing the goods and services demanded by modern society.

The construction industry was apparently especially susceptible to the depression. Its condition, which represents perhaps an extreme case, indicates some of the stresses and strains put upon our marketing system. The construction industry fell from a pre-depression value of \$11,000,000,000 to \$3,000,000,000 in 1934. Home construction alone declined from \$3,000,000,000 to \$3,000,000. The decline in building, according to some estimates, added 3,500,000 workers to the unemployed group and, including those indirectly affected, 5,000,000 people. At the beginning of 1935 one estimate placed the shortage in durable goods at 1934 prices at \$55,000,000,000 plus a shortage of \$25,000,000,000 in buildings, and \$5,000,000,000 for under-maintenance and needed new equipment of public utilities and railroads—a total of \$85,000,000,000. It would take industry ten years, operating at 25 per cent above normal, to liquidate this shortage.⁴

It is estimated that more than \$5,000,000,000 has been invested in 26,000 hotels having in excess of 1,500,000 rooms. Approximately \$2,750,000,000 had been invested in the motion-picture industry

¹ The figures are based on reports of the 1930 Census.

² This information is taken from different governmental reports.

³ The significance of the data cited here is discussed in other chapters of the book.

⁴ *Bull. of Cleveland Trust Company*, Dec. 15, 1934.

by the beginning of 1929. The asset value of the electric power industry increased from \$500,000,000, in 1902, to \$12,500,000,000, in 1932.

During the period 1920-1929 the volume of manufactured goods increased at the rate of 4 per cent a year, while the population increased at the rate of only 1.4 per cent a year. The output per man in manufacturing establishments grew at the rate of 3.5 per cent a year. From 1900 to 1930 the number of wage earners increased faster than the population, while the hours of labor decreased 15 per cent and the physical volume of production increased 300 per cent.

Changes in the Character of the Market.—Markets have increased in size and complexity during recent years. The population of the urban sections has been increasing at a more rapid rate than that of the rural districts. The statement that 1,500 freight cars a day are required to supply merchandise to New York City alone indicates some of the marketing problems arising as a result of the concentration of people in small areas. Buying power of the masses increased steadily from 1921 to 1930. Buying habits during the last decade shifted, and wants grew both in number and in variety.

The development of the desire for better things in life has been promoted by federal and state governments, our educational systems, and the automobile and good roads which make travel and touring not only possible but also enjoyable. The motion picture and the radio have done much to create a desire for goods and services which the consumer might not otherwise know of until a much later date. The parcel post system made possible the rapid growth of the great mail-order houses and played an important part, as also did the newspaper, magazine, national, and local advertising, in stimulating the rising standard of living in the rural communities.

The following figures indicate the tremendous purchasing power that has arisen. New life insurance in excess of \$18,500,000,000 was written in 1929; \$14,000,000,000 of new life insurance was written in 1934, an increase of 10.1 per cent over 1933. Approximately \$98,000,000,000 of life insurance was in force at the beginning of 1935. The average face value of 93,000,000 life insurance policies in force in 1934, in forty-four principal companies, was approximately \$1,100. It was estimated that approximately 65,000,000 people carried insurance and that the companies supplying the insurance had assets of more than \$18,250,000,000. Accumulated savings in 1933 amounted to \$50,000,000,000; there were 40,000,000 savings accounts and 10,000,000 building and loan accounts. Each of 13,686,947 savings bank depositors had an average of about \$700 on deposit July 1, 1934. The 138 mutual savings banks of New York were reported to hold \$3,562,095,000 in real estate mortgages in addition

to \$1,853,702,000 in government and corporation bonds. Dividends paid by American corporations in 1934 equaled \$2,684,700,000.

The use of electrical apparatus in the home is widespread. There were, at the beginning of 1935, more than 20,500,000 homes wired for electricity, and the number is constantly increasing. Fifty-six and two-tenths per cent of the homes had radios in 1933, and 3,500,000 radio sets, valued at \$112,279,565 factory price, were manufactured in 1933. This represents a decline in value of 40.2 per cent from 1931. Five million new owners, however, were added from 1929 to 1934; 4,084,000 sets were bought at a cost of \$165,000,000 by radio listeners in 1934, compared with 4,438,000 in 1929, the previous peak. About two-thirds of these are believed to have been for replacements. Automobile radios and all-wave sets were largely responsible, together with lower prices, for this increase.¹ The effect of radio demand upon the sales of phonographs is indicated by the fact that only \$301,436 worth of the latter were reported sold in 1933. There were approximately 16,800,000 telephones in use at the beginning of 1935. The number was probably in excess of 19,600,000 in 1930. At the beginning of 1935, approximately 6,000,000 household mechanical refrigerators were in use; more than 1,300,000 units were added in 1934, but the saturation point apparently is far distant since less than 30 per cent of the homes wired for electricity are equipped with refrigerators.

An all-time peak to this date was established in 1934 for the production of cigarettes and radios and in the sales of gasoline, incandescent lamps, and electrical refrigerators.

Changes in habits of living generate changed buying practices on the part of the consumer. Fewer people now live in single-family dwellings and more in apartment houses than fifteen years ago. More women work outside the home and fewer in the home. The average size of the family is decreasing; the population trend is toward a lower proportion of children and a larger proportion of adults. Less of the family income is spent for staples and necessities, while more is spent for luxuries. It is estimated that from 1900 to 1920 the number of restaurant waiters increased about three times as fast as the number of families, and restaurant owners increased four times as fast. The sales of restaurants in 1929 were approximately \$2,500,000,000. Bakery production increased 60 per cent from 1914 to 1925; delicatessen dealers increased 43 per cent from 1910 to 1920, or almost three times as fast as the population. The

¹ According to a report of the Columbia Broadcasting System, Inc., there were 21,450,000 radio homes as of January, 1935; there were 4,000,000 more radios than passenger automobiles, and twice as many radio homes as telephone homes in the United States.

rapid growth of the hotel, restaurant, and delicatessen is due in part to the changed activities of women.

The increased money incomes and shorter working hours give the public more leisure. This means it has more time in which to spend and to enjoy the fruits of its efforts. The result is an "accelerated growth of our service industries—travel, entertainment, education, insurance, communication; the facilities of hotels, restaurants, delicatessen stores, steam laundries, and public libraries, to mention a few."¹ Retail sales of service establishments for 1933 amounted to \$2,214,024,581.

Seventy-one per cent of the world's 36,500,000 motor vehicles were registered in the United States in 1935;² \$1,650,000,000 was invested in rural roads and for street construction and maintenance; 24,933,403 motor taxpayers paid a total tax bill in excess of \$1,200,000,000 in 1934;³ they bought 16,150,000,000 gallons of gasoline in 1935. There was a passenger car for each group of six people in the United States in 1934. The number of new passenger motor cars registered in the depression year of 1933 was 1,493,794. There were 49,000 more filling stations in 1933 than in 1929. The number of garages, restaurants, and combination food stores likewise increased materially during the period. Approximately \$115,895,370 was spent by 4,858,178 sport fishermen in 1933 for licenses, tackle, transportation, guides, boat hire, and lodging.

The sharp shift in the style of women's clothing illustrates the far-reaching effect of a change in demand upon industry. The demand for woolen and worsted cloth gave way to silk, rayon, and furs; the short skirt, for instance, curtailed demand not only for wools but also for cottons and greatly augmented the demand for silk hosiery and novelty-style shoes.

Changes in Marketing Organization and Methods.—The logical conclusion to draw as to the result of the changes in production and demand is that there must be adjustments and readjustments in the set-up and operation of the marketing machinery. A number of significant changes in organization, policies, and personnel have been made in an attempt to meet the difficulties generated by the conditions outlined above. These changes have not, however, proved entirely satisfactory.

The number of persons engaged in trade and transportation increased from approximately 3,300,000, in 1890, to 13,000,000, in 1930. There

¹ *Recent Economic Changes in the United States*, Vol. I, p. xvi.

² The number of new automobiles produced in 1935 is estimated at approximately 3,600,000. Only 4,000 automobiles were manufactured in 1900.

³ The consumers paid a total motor-fuel tax bill of \$740,000,000 in 1934, and a total federal tax of \$736,939,967 on tobacco, liquor, dividends, and excess profits for the fiscal year of 1934. *New York Journal of Commerce*, Jan. 21, 1935.

has been a decided trend, since 1920, toward marketing goods in a direct line from producer to consumer. This movement has been to the disadvantage of certain members of the orthodox organization.¹ The orthodox system of distribution for manufactured consumers' goods is usually thought of as comprising the following set-up: producer to wholesaler or jobber, to retailer, to consumer. For agricultural products it varies according to classes of goods, *e.g.*, live stock, grains, and fruits, but in general it is as follows: producer to local buyer or shipper, to a merchant or an agent in the central market, and to the packers, in the case of live stock; to the exporters, speculators, and millers, in the case of the grains; or to wholesale commission men, to jobbers, and to retailers, in the case of fruits and vegetables.²

The so-called orthodox system, as indicated above, was found inadequate to meet the needs that arose as a result of the changes taking place with reference to production and to the nature of the demand. The movement toward adjustment was started from two different points in the orthodox system. (1) The producer—the manufacturer and the farmer—began working out new plans. The manufacturer, through branding and national advertising, attempted to establish a firm control over the sale of his product. His methods, however, often raised protests from the wholesaler and the retailer. The farmer worked along lines of cooperative organizations and also resorted to political action. (2) The other attack upon the orthodox system developed in the ranks of the retailers. Here we find the mail-order house, the department store, and, since 1921, the tremendous development of the chain store and the independent retailers' cooperative buying associations. These changes naturally created considerable confusion in the field of marketing and, obviously, tended to intensify the problems of buying and selling.

The outstanding change in marketing organization developed from within is the chain store. We now have the simple chain-store system, comprising a number of retail outlets of similar kind and size under one centralized management; chain departments operating in department and specialty stores in certain merchandise lines; retailer-owned, jobber-owned, and manufacturer-owned chains of specialty and department stores; mail-order-house-owned chains of department stores; and associations of independent stores for buying, advertising, and research. The development of integration in marketing has assumed three forms—vertical, horizontal, and circular. Vertical integration brings under one control a number of firms, each performing an essential step in the

¹ Strenuous efforts are being made by many affected middlemen to retard this movement. This point is discussed in later chapters.

² Cotton, tobacco, dairy, and poultry products have rather well-established typical organizations for facilitating buying and selling.

production and marketing processes. Horizontal integration brings together under one control a number of similar units, e.g., forming a chain of stores. Circular integration brings under a central control a number of companies which produce a related but non-competing number of articles so that a complete and well-rounded line of products can be offered; a stronger merchandising line-up results, as well as possible economies and increased control over prices and services. The rapid growth of integration has had, perhaps, an adverse effect upon the independent wholesaler and retailer. The chains, department stores, and mail-order houses buy in such large quantities that they can go directly to the manufacturer, and, in some instances, they actually own or control manufacturing plants. The associations of independent retailers are also large enough to buy direct, thus eliminating many of the orthodox independent wholesalers.

In addition to the phenomenal growth of the chain store, the difficulties of the independent wholesaler and retailer, the greater emphasis of the manufacturer and the farmer upon the marketing function of their business, hand-to-mouth buying, and installment selling, there has been another development of considerable importance since 1920. This development is the growth in the size of the sales territory of the retail store that handles shopping lines and is located in the larger towns and medium-sized cities. This is due to the customer's growing interest in style, assortment, and variety, and the cultivation of demand by means of radio, motion picture, and magazine advertising. The great distance over which consumers can now go to shop is made possible, of course, by the automobile and good roads. These same factors have caused the failure of many small-town retailers.

The traffic congestion in the down-town sections of large cities, on the other hand, has started a decentralizing movement on the part of certain retailers. Thus some of the large department stores have established branches in the suburbs; many outlying business centers are benefiting from the aversion of the public to the inconveniences met in attempting to park and shop in the central trading zone. The alert merchant has learned that trade is mobile because it now can go conveniently where the inducement—in the form of style, quality, service, variety, and price—is sufficient.

The kind of merchandise sold in specific stores has changed; for instance, the Bureau of Foreign and Domestic Commerce found in one of its surveys that hardware stores sell jewelry and cigars as well as plumbing supplies and thirty-eight other commodities. Women's clothing stores sell men's furnishings, leather goods, and kitchen ware. Candy stores sell vegetables, sporting goods, women's hosiery, and forty-five other articles. Baltimore purchases 68 per cent of its men's hats

from hat stores but less than 48 per cent of its men's clothing from clothing stores.

Increased Governmental Activity.—The devastating effects of the depression caused large numbers of farmers, manufacturers, merchants, laborers, and consumers to lose faith in their own ability to cope with the problems of declining sales, unemployment, and increasing deficits. The drastic decline in farm income, for example, so reduced the purchasing power of the rural communities that the effect was keenly felt throughout the industrial sections.

The effective demand under depression conditions is not great enough to use, at their normal capacity, the productive facilities of our farms, factories, and mines and of our transportation and other service agencies. This situation indicates that large numbers of producers cannot sell their goods and services for a price that will permit them to buy the goods and services of the other producers. The solution of the problem is not clear. Some turn to political action and others to invention, organization, and better management. A combination of all, perhaps, is needed.

There is an increasing tendency for those in the first class to form "pressure groups" so as to influence legislation and governmental action for the benefit of favored classes in the guise of social reform, relief, the transfer of income and of wealth, and other social and economic objectives.

The federal government was prevailed upon to set up the A.A.A. to aid the farmer in solving his financial, production, and marketing problems; the N.I.R.A., with its codes was designed to aid the merchants, service groups, and labor. A number of relief agencies provided purchasing power through various forms of work projects and direct relief for financially burdened home owners and the unemployed. The federal government paid out through these agencies, for the benefit of public and private enterprises, during 1934, an amount estimated at approximately \$4,000,000,000 and a sum somewhat in excess of this figure in 1935. There are differences of opinion as to the long-run value of many of the governmental acts. Those who needed the aid and others who were beneficiaries, in one form or another, were pleased. Those who received little or no direct benefit view with alarm the mounting deficits and the approaching tax bill. The situation is similar, in some respects, to a war. One may object to the cost but wonder whether he might not have to pay more if nothing were done to alleviate the unfavorable conditions. The government actions, no doubt, create new marketing problems for business as well as aid in solving others.

The group that turns to what may be termed individual enterprise and scientific management for a solution places the emphasis on business management, research, invention, and governmental regulation rather

than on governmental planning, operation, and control. The possibilities offered by invention are quite promising. Some new developments which may aid in reducing unemployment, and thereby increase demand for some of the older products and at the same time provide new products and services, are mentioned in the following quotation:¹

Air conditioning temperature and humidity control in homes, offices, schools, hospitals and other public buildings.

Light, streamlined, low center of gravity trains for speeds of 100 to 200 miles per hour.

Electrification of all railroads.

Trunk highway systems avoiding cities and town and separating passenger cars from trucks.

Highway lighting, making high-speed night driving safe.

Flying at high altitude for increased velocity and economy, automatic piloting, and landing control from ground.

Complete substitute for visual control, perhaps including microaltimeters and microfathometers, for making flying and navigation safe in thick weather.

Home teletype by radio, giving up-to-the-minute news.

Home motion pictures by radio.

Home television for events of interest.

Reduction in cost of power as by mercury boiler, coal used at mine, etc.

High voltage, direct current transmission, reducing power costs and extending economic radius.

New materials—improved textiles, new synthetic resins replacing wood, metals and other natural materials for many purposes; new alloys, new structural materials giving better heat and sound insulation.

Production of new and useful mutations and control of malignancies by X-rays.

Elimination of slums, extension of parks, widening and beautifying city streets.

Household drudgery ended by complete electrification of every home.

The broadcasting of motion pictures by radio and home television sets.

Present-day discoveries regarding neutrons, positrons and tritrons may be expected to bring practical advances as important as those dependent on the electron, which brought us radio, talking pictures and television.

One does not need to be an expert in economics or marketing to recognize the marketing implications of the foregoing quotation.

Summary.—The close relation existing between the production process and the marketing process, as suggested above, indicates quite clearly that the solutions of our marketing problems must take into consideration the production aspects of any given situation. One of the most important problems of marketing is to determine what to buy or produce,

¹ WHITNEY, W. R., vice president in charge of research, General Electric Company, *New York Journal of Commerce*, June 14, 1934.

how much, when, where, what size, quality, quantity, and design. The major difficulties of a number of industries today are due to the fact that they are producing and *trying* to sell at a profit too many goods that are not wanted, and are not producing enough of the kind and quality that are wanted.

A solution of the problems of selling for any given situation calls for a knowledge of the market, its size, location, and the general characteristics of the demand—what is wanted, when, and why. Successful and economical marketing practice is dependent upon an appreciation of, and a suitable adjustment to, all those changing conditions in our economic and social life that so vitally affect buying and selling procedure.

The problems of marketing have been intensified and complicated by the large amount of unemployment, declining purchasing power, rising costs, governmental action, changed methods of living, the disappearance of established forms of demand, and the appearance of new ones. It is encouraging to know, however, that many business men and government officials are alive to the situation. Greater emphasis is now being placed on market analysis, population and consumer studies, sales analyses and costs, product design, marketing methods, and the inefficiency due to so much duplication in marketing organization and activities.

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Questions for Discussion

1. "We can produce more than enough for everybody in this country." Evaluate this statement carefully. Do you agree? Justify your answer.
2. "The character of our productive activities and the continued operation of the economic system depends upon the ways in which the people currently dispose of their incomes." Explain this relationship.
3. "Marketing, to the economist, is then a part of production. The business man, however, speaks of marketing as distribution." What activities does the economist include under the term "production"? What does the business man mean by the term "distribution"? How does his meaning differ from the economist's meaning of the same term?

SOME SIGNIFICANT ASPECTS OF MARKETING

4. "The separation of marketing from the other phases of production is simply a case of the division of labor." Do you agree that marketing is a "phase of production"? Justify your answer.
5. "In earlier times there was no problem of distribution because people lived simply and produced their own foodstuffs and clothing materials and found fuel and materials from which to create shelter close at hand." Draw up a list of industrial, social, and economic changes and developments that have made marketing one of our most important business activities.
6. Compare and contrast the powers of the guild merchants of medieval England with the codes of N.I.R.A.
7. "The conditions surrounding consumption have had quite as distinct an influence upon these problems [marketing] and the mechanism which has been developed for this solution." Indicate how the changed conditions of consumption have affected marketing problems.
8. "To the man who looks beyond the immediate moment, who is concerned with the condition which will face society five, ten, and fifteen years from now, it is essential that the principles involved should be clarified." How can this aim be accomplished?
9. "The function of marketing is to aid in the satisfaction of wants at the lowest cost consistent with satisfactory service." Is this statement acceptable to both the buyer and the seller? Justify your answer.
10. "The day is gone when the recipe for fabulous profit was simply production; more production; still more production! The age of distribution is upon us." If true, what is the significance of these statements?
11. "Important technical developments of the last half century have had a marked effect on both the methods and policies of retail stores." What are they? Show how each has affected retailing.
12. How has development in transportation, advertising, and varying size of producers affected the marketing problem?
13. "The performances of some of the retail functions are more difficult than they have been in the past; others are easier to perform." Illustrate.
14. What are the policies of modern retailing that emphasize the changed conditions in the methods of retail selling?
15. "What is needed is a greater appreciation and understanding of the underlying economic basis for the rise in the cost of distribution." List and explain these underlying economic causes.
16. "Whether we live under a wage, price, and profit system, or under a complete communistic method of economic organization, it will always be true that the level of consumption or the standard of living can be raised only through the production of food, clothing, shelter, comforts, and luxuries." Do you agree? What is the marketing significance of the statement?
17. "A dynamic society cannot escape the fact of surge and setback that seems inseparable from the living disorder of growth which, for all its casualties, invests life and enterprise with a stimulant challenge that utter certainty could never provide." Do you agree? How does such a situation affect the action and thought of entrepreneurs? Of consumers? What is a logical solution?

CHAPTER II

MARKET POTENTIALS

Purpose of this chapter: To define the concept market; to analyze the characteristics of the market and the nature of purchasing power—what it is, how it is created, how it is distributed; and to determine how purchasing power affects consumption.

The concept *market* implies people and goods—demand and supply. Upon second thought one realizes that the term may suggest wants, purchasing power, competition, prices, and perhaps a place. Just what then does this word market signify? The word has several meanings; the meaning in any given instance is likely to depend on the particular use of the term and the personal opinion of the individual speaking. It is not unusual for a speaker to give the symbol one meaning in a sentence and then use the word in a different way in the next sentence.

The Meaning of the Term Market.—An examination at this point of some of the more frequently used meanings will be of value in our subsequent study. Cournot, a French economist, says, for instance,

Economists understand by the term, market, not any particular market place in which things are bought and sold, but the whole of any region in which buyers and sellers are in such free intercourse with one another that the prices of the same goods tend to equality easily and quickly.

Jevons, an eminent English economist, gives us a definition in more concrete terms and at the same time brings out the evolutionary character of the concept.¹ He says,

Originally a market was a public place in a town where provisions and other objects were exposed for sale; but the word has been generalized so as to mean any body of persons who are in intimate business relations and carry on extensive transactions in any commodity. A great city may contain as many markets as there are important branches of trade, and these markets may or may not be localized. The central point of a market is the public exchange mart or auction rooms, where the traders agree to meet and transact business. In London the

¹ Among writers in the field of marketing we find the following statements: "A market is, then, a center about which the forces leading to exchanges of title operate, and toward which and from which the actual goods tend to travel." F. E. Clark, *Principles of Marketing*, p. 5, 1932.

"A market then is merely such potentialities as compose an opportunity for the purchase and sale of goods." R. F. Breyer, *The Marketing Institution*, p. 54.

Stock Market, the Corn Market, the Coal Market, the Sugar Market, and many others are distinctly localized; in Manchester the Cotton Market, the Cotton Waste Market, and others. But this distinction of locality is not necessary. The traders may be spread over a whole town, or region of country, and yet make a market if they are, by means of fairs, meetings, published price lists, the post office or otherwise, in close communication with each other.

A Perfect Market.—The economist frequently uses the expression “a perfect market.” It is said that a perfect or completely organized market exists when buyers and sellers of a single commodity, engaged in active competition with each other, come together, in person, through agents, or by various methods of communication, in commercial intercourse so free and general and attended by so much publicity with regard to their mercantile activity that they establish a single price at which the commodity exchanges ownership.

The student will recognize immediately that the conditions making a “perfect” market are rarely found in the *proper* combination. The highly organized stock exchanges on which internationally known securities are dealt in, the English market for gold and silver, and some of the produce exchanges, such as the Chicago Board of Trade, come the nearest to possessing the attributes of the economist’s perfect market.

Some Essential Attributes of a Market.—The definitions of the term market so far presented show that there are in reality three concepts involved, *viz.*, (1) the location, which is indicated by the use of the words *place*, *region*, and *district*; (2) the organization, *e.g.*, as indicated by the use of such terms as the *traders*, *exchanges*, the *stock market*, and *fairs*; and (3) the price-making factor. The economist places great emphasis upon the tendency toward a “single price for the same commodity at a given time, arrived at under free and open competition.”

The Market Is, Necessarily, a Group of People.—A market may be thought of, for practical purposes, as a group of people who stand ready to buy a particular product or service at a given time for a definite price.

There are several possible ways in which a market may be designated and discussed; for example, the *location* of these groups of buyers may be used to classify the markets. The term is used in this sense when we speak of the domestic market and the foreign market; the national and the international or world markets; the urban market and the rural market; the local market and the central or terminal market. Quite frequently the *time element* of the market is used as a basis of classification. Then such expressions as future, cash or spot, seasonal, summer, holiday, temporary, permanent, continual, and intermittent markets are used. When the *price-making factor* is used as a basis of classification, we hear such expressions as the ruling market, a selling or a buying market, a competitive or a monopolistic market. The name of the organizations

or the institutions used to facilitate the sale of the goods is sometimes given to the market; thus we have the retail, the wholesale, the chain-store, and the department-store markets.⁶ The *nature of the utilization* of the goods or the purpose in buying may be used to designate the market. Under this classification we find the consumer, industrial, agricultural, and institutional markets. The consumers may be divided on the basis of occupations into professional, labor, domestic, and other corresponding groups; the industrial market may be broken down along the line of the nature of the process of manufacturing or the character of the product turned out; the institutional group divides naturally into several well-defined classes, such as educational, health, and financial. The educational group may be separated into sub-groups, e.g., public and private schools; state-supported and privately endowed institutions; elementary and high schools, colleges, and universities.

The name of the *product* bought and sold is sometimes given to the market, as the stock, grain, live-stock, milk, wheat, cattle, and cotton markets. Another basis of classification is that of *control*. This method of grouping applies to the organized or semi-organized facilities making for the convenience of the buyers and sellers or their agents. Under this classification we find municipal and public markets and more or less independently organized and operated exchanges, such as the Board of Trade, Curb Market, New York Produce Market, and the Chicago Stockyards Company.

The buyer is likely to think of the market as a place where he secures the merchandise he wants, as the meat market, green market, grocery, drug, and other retail stores. The producer or seller may think of his market as the place where he disposes of his goods. Thus the farmer may think of the country buyer, the meat packer, and the cream station as his markets. The manufacturer may think of the wholesaler and the retailers as his markets. The man who deals in securities may think of the New York Stock Exchange as his market.

The foregoing illustrations of different bases of classification present in a concrete manner an explanation for the many and diverse meanings given to the term market and indicate the necessity of knowing what meaning is intended when the word is used. Fortunately, the context of the sentence or paragraph usually makes the user's meaning fairly clear.

Classification of Buyers and Sellers.—According to our definition, one of the attributes of a market is "a group of people who stand ready to buy." This implies a *willingness* to purchase, which is the personal or psychological aspect of the market and is controlled, to a considerable extent, by custom, habit, and various individual and class motives.¹

¹ The psychological aspects of the market are analyzed and discussed in Chap. III.

Another implication equally important as willingness to purchase is *ability to buy*.

A sale-purchase transaction cannot be consummated unless there are people ready to sell as well as to buy. One of these classes is as essential as the other in a marketing transaction, yet it is not always possible to draw hard and fast lines of division because an individual or a firm is normally both a buyer and a seller. It will be of assistance in securing a clearer understanding of the marketing problem, however, if we consider the buying and the selling activities separately.

The Buyers.—We can facilitate our discussion of buyers by grouping them under five major classifications. One group, the *producers*, comprises all of those individuals and firms that purchase raw materials, supplies, equipment, and services for the purpose of using them, either directly or indirectly, in the production of some form of merchandise or service. The characteristic feature of the buying by the members of this group is that they buy not to satisfy a personal need or whim but from a utilitarian motive. They keep constantly in mind the effect of the cost, the quality, performance, and the like upon the final cost, quality, appearance, and performance of the article or service they are producing to sell to some one else.

A second aggregation comprises all those buyers who purchase for the purpose of *reselling* at a profit. They are known as *merchants*. The more familiar of these are the large variety of wholesale merchants and the many different kinds of retailers. The characteristic feature of the buying of these groups is that they attempt to interpret the wants, likes, and dislikes of the ultimate consumer, and to estimate his purchasing power, and then buy the merchandise they think will best suit their clientele. The success of the individual merchant is in direct ratio to his ability to interpret accurately the wants of his customers.*

Institutions, such as schools, governmental units, hotels, hospitals, and banks, make up another class of buyers. This group has some qualities that are similar to some of those in the two groups mentioned above. The distinguishing feature, however, is that what it buys is used to aid in producing and selling the service which is offered to the clientele of the particular institution concerned. While these institutions do resell some merchandise which they have bought and may even produce tangible goods, these are not, however, their major activities. They are only incidental to the sale of the services, the primary good.

Agents, the fourth class of buyers, comprise a rather miscellaneous group of purchasers who do not buy for their own account but furnish their specialized services and superior trade connections to the three groups mentioned above. The nature of their buying is determined,

therefore, by the wants and needs of the firm or individual for whom they operate, be it a producer, an institution, or a merchant.

The last member in our major classification of buyers, the *ultimate consumer*, is quite different from the other members. This group comprises every one—professional man, laborer, farmer, business executive, clerk, and housewife—who buys merchandise and services to satisfy the personal needs and wants of himself or the immediate members of his family. The individuals in this group buy with the idea of satisfying their personal desires rather than for the purpose of resale or for the facilitation of production.

The Sellers.—Sellers may be grouped under the five classifications which were used in grouping buyers. The producer is now interested in selling his finished product to other producers and to institutions, merchants, and ultimate consumers. The merchants, institutions, and agents are likewise engaged in disposing of their merchandise and services, at a price that will yield a satisfactory profit, to their different kinds of customers. The ultimate consumer as an individual is vitally interested in selling his personal service at or above the going market price and under conditions which he considers reasonable.

Classification of Goods.—Another requisite of the market is an economic good.¹ A better understanding of how the product and its outstanding characteristics affect the problem of marketing may be secured by some useful grouping of products according to certain attributes. The value of any basis of classification depends, manifestly, upon the use to be made of the classification.² One basis of classification will be useful for one purpose, while another basis may be best for a different purpose. The two most frequently used classifications are made on the bases of the *source of the goods* and the *nature of the use*.

The Source of the Goods.—Economic goods may be classified, on the basis of their source, into four major groups, *viz.*, natural goods, agricultural products, manufactured products, and services.

Natural goods comprise land, water power, and the output of mines, forests, and the waters. The distinguishing feature of the members of this group is that they are taken directly from nature and turned into the channels of industry. The value of the annual production in the United States alone of crude oil, coal, iron ore, copper, timber, and fish, to mention only some of the more important natural products, amounts to millions of dollars annually. Natural resources have furnished the

¹ This does not mean, however, that the particular commodity or service has to be in existence at the time the sale is consummated. Futures markets may deal in contracts for the delivery of products as yet non-existent.

² For a summary of classifications proposed by Copeland, Duncan, Converse, and Rhoades, see P. D. Converse, *Elements of Marketing*, pp. 123 ff.

is for much of the economic prosperity throughout the world since beginning of time, and especially since the beginning of the Industrial revolution.¹

The second group of goods, classified on the basis of source, comprises *agricultural products*. These products are the results of man's work directly with the forces of nature to produce, for example, fruits, vegetables, grains, fibers, dairy products, and live stock. It is from this that the materials for the world's food and clothing are largely derived. The nature of these products and the conditions under which they are produced and consumed create a number of difficult marketing problems.²

Manufactured goods form a third group. Manufacturers, with the aid of labor, tools, machinery, and power, change the form of a large quantity of agricultural and natural products to meet the needs of the different classes of buyers. Thus iron ore is changed into steel and then into locomotives, automobiles, plows, stoves, and typewriters; coal is changed into heat, coke, gas, and tar. The last, formerly a waste product, is now used to produce dyes, pharmaceutical products, explosives, and other chemical compounds. Hogs, cattle, and sheep are raised for their meat and hides and as such are classed as agricultural products, but when taken to the meat packing plant

their carcasses start on a route which branches into an astonishing number of paths, producing meat, and manufactures of meat; bones, from which are made white articles, such as knife and brush handles, charcoal, bone black, tanned feed and fertilizer; fats, bases of soap and many other things; certain oil chemicals; and offal, which is made into glue, gelatine, grease, and fertilizer. Hides form the raw material of a chain of plants starting with tan vats, from which the leather produced is split into two or more layers, and worked through various processes to form many grades and kinds to go on into the plants producing shoes, straps, handbags, gloves, pocket cases, and a thousand other articles.³

The problems of marketing for this class of products are greatly complicated by the character of the demand as well as by the characteristics of the products and their methods of production.⁴

The fourth classification comprises a large list of intangible goods which may be designated as *services*. In this group are found human services, e.g., labor, professional, and managerial; mechanical, e.g., forms of transportation, communication, printing, and power; institutional, e.g.,

Chap. XII for a discussion of the marketing of natural products.

Chaps. IX, X, XI, and XIX for a discussion of the marketing of agricultural products.

BUNNELL, S. H., *Industrials: Their Securities and Organization*, p. 77.

Consult Chap. XIII for a discussion of some of the problems encountered in marketing manufactured products.

the varied services furnished by commercial and investment banks, insurance companies, hotels, hospitals, theaters, and educational institutions. The commercial demand for services increased greatly after the World War, as evidenced by the billions of dollars expended for facilities to produce the many different kinds of services and by the millions of dollars spent annually for the services themselves. It appears that as the per capita income of a nation increases and the standard of life rises there is a greatly augmented demand for the services enumerated above.

• The characteristics of this group of economic goods are so different from the three other classes as to present unique marketing problems.¹

The Use of the Goods.—Goods may be classified, on the basis of their use, into two major groups, *viz.*, for use by industry and institutions and for the use of the ultimate consumer.² This method of classification is frequently of most value to the seller in locating and cultivating the demand for his output. If he knows the use to which his product is to be put, he is in a better position to design, revamp, and otherwise make adjustments so as better to serve his market. He is able at the same time to point out to the buyer and the prospective buyer just how the product will meet their needs.

Industrial Goods.—Goods purchased by industry are used either as raw materials or as equipment, supplies, and other aids in *production*. Raw materials are goods consumed in making finished or semi-finished products. The term "raw material" is really a relative term, as a good may be used as a finished product in one industry and as a raw product in another. Leather, for instance, is the finished product of the tannery, but one of the raw products in the shoe industry. Flour is the finished product of the miller, but raw material for the baker. Raw materials, therefore, may come from one or more of the four sources given above.³ Whether a product is so classed, however, depends entirely upon its use rather than upon its source. Some products used as raw materials are graded to strictly established standards and have to be sold at competitive market prices. Nothing is left for the seller of such goods to offer as an argument for purchasing his particular product except such factors as lower transportation costs due to location, better credit terms, or superior service in delivery, order taking, and packing.

Some manufactured goods are bought by producers, merchants, and institutions for the purpose either of aiding in the construction of their finished product, *e.g.*, factory equipment, supplies, and office appliances,

¹ Cf. Chap. XIV for a discussion of the marketing of services.

² It is sometimes advantageous to classify goods on the basis of *durability*; thus both industrial and consumer goods may be divided into two sub-classes, *viz.*, (1) durable and (2) non-durable goods.

³ Cf. p. 29.

or of attaching, as accessories and original equipment, to their completed product. Thus a manufacturing plant may buy a number of electric motors as factory equipment, or a washing machine manufacturer might buy wringers with which to equip his machines. These articles, under such conditions, are classed as *industrial goods*. On the other hand, when a farmer buys a motor from his local hardware dealer or from a mail-order house to put on his washing machine, the motor is a consumer product not an industrial good. The markets are quite different in the two illustrations, necessitating different methods of analysis, service, and development.¹

Consumers' Goods.—The second major classification, on the basis of use after purchase, is *consumers' goods*. In this group we find services and manufactured, agricultural, and natural products. The buyer—the ultimate consumer—may purchase directly from the producer or he may purchase from a retailer who has bought the merchandise from a wholesaler, jobber, broker, manufacturer, or importer, for the purpose of resale to the consumer. The consumer spends yearly, we learned in Chap. I, large sums of money for rent, taxes, professional services, amusements, food, clothing, and many articles of luxury. Producers and merchants who sell to the ultimate consumer must take into consideration his likes and dislikes concerning design, quality, price, and service. As there are many different classes of consumers, careful study is necessary in order to produce the proper quantity of the desired design, quality, and price in time to meet the demand.²

FACTORS THAT DETERMINE A MARKET

A study of the factors that determine the market for any given product involves two considerations: (1) ability of the people to buy and (2) the need or desire for the product or service, which may be real or imaginary, latent or active. The same view is expressed in the following quotation: "A potential market may be defined as a given area containing people who are merely 'able to buy,' while an active market is one in which there are people who are willing and ready to buy."³ One can readily confuse a willingness to buy with the ability to buy, yet a clear distinction is essential to a satisfactory solution of marketing problems.

*Importance of Coordinating Production with Demand.*⁴—One of the major problems of modern industry is to adjust production capacity and the supplies of goods to present and future market needs. This

¹ This subject is developed in more detail in Chap. XIII.

² It is sometimes useful to classify consumer goods on the basis of consumer buying habits into (1) convenience goods, (2) specialty goods, and (3) shopping goods (see Chap. XIII).

³ "Market Data Book of New England," *Domestic Commerce Ser. 24*, p. 3.

coordination of production and the needs of the market demands, on the part of management, a definite knowledge of *what* to produce, *how much* to produce, *when* to produce, and *where* to produce. This information can be secured only after learning who *can* and *will* buy. Why do or will people buy this *particular* product or service? What are their buying habits, customs, and prejudices? The dynamic character of our social and economic life makes it difficult to secure definite answers to these questions.

• A lack of knowledge along the foregoing lines explains in part the sad plight in which the producers of rubber, coffee, sugar, wheat, cotton, coal, copper, tin, nitrate, and oil found themselves during the 1920's and 1930's. Attempts, under governmental leadership, have been made in Brazil, France, England, the United States, and many other countries to bring about a proper relationship between production and demand for certain agricultural products. The efforts have not always been as expected and desired. The manufacturers of woolen textiles, musical instruments, steel, and industrial equipment, for example, have suffered because of excess capacity due to a diminishing market. The automobile manufacturers, on the other hand, seem to have profited by experience so that since 1924 their output has been fairly well adjusted to market needs.

The ideal is to determine, well in advance, the market potentials and then gear production accordingly. The development of the particular technique for any given business is a task for the marketing executives of the firm. It is within the province of our study, however, to consider the factors that reflect the *purchasing power* of a market. The remainder of this chapter is given over to this aspect of market information. The following chapter considers the other factors of demand.

Measuring Market Potentials.—The sale of most products is usually conditioned by a number of factors; consequently, it is no simple matter to select the factor or a set of factors that accurately indicates the purchasing power of the county, city, trading area, class of buyers, or other unit that may be selected. The possible purchases of automobile tires may be estimated from the trend of automobile registrations over a period of years, while the sale of certain low-priced electrical appliances may be estimated from a knowledge of the number of wired homes. Such simple indexes are not available, however, for the great majority of goods and services sold. Much time, study, and money have been spent by research men employed by magazine and newspaper publishers, advertising agencies, industries, and various governmental agencies, in an attempt to isolate the factors that will give a reliable index of consumer purchasing power. The *Census of Distribution for 1929*, the *Census of American Business for 1933*, and the *Census of Agriculture for 1934*,

furnish valuable information for market analyses which was not hitherto available.

Conditions That Determine the Ability to Buy.—It is possible to approach the problem of determining the purchasing power of a community through an analysis of the factors that determine the amount of income received in any community during a given period. There are three outstanding elements that condition and determine the amount of income. They are the geographical conditions, population characteristics, and economic development.¹

The Geographical Conditions.—While geographical factors affect both purchasing power and needs, we shall consider at present only the effect on buying ability. Differences in topography, soil structure and fertility, rainfall, temperature, mineral and forest resources, harbors, water power, navigable streams, and other natural resources determine the character of the industries that dominate a locality; these industries in turn influence the make-up, prosperity, and standard of living of the people. It may safely be left to the reader's experience, observation, and imagination to supply cases illustrating *how* and *why* the incomes of people living in torrid and frigid zones, mountainous regions, regions rich in natural resources, and large urban centers differ from the incomes received by people living in various sections of the temperate zone, on alluvial plains, in regions lacking natural resources, or in rural communities.

Population Factors.—A detailed knowledge of the outstanding characteristics of the people within the market area is of value in determining their purchasing power. This factor is reflected by both quantitative and qualitative characteristics of the population. It is sometimes advisable to classify the population on various bases and determine the number in each class. The bases most commonly used are age, sex, nationality, race, religion and church affiliation, occupation, citizenship, and amount of illiteracy; home owners versus non-home owners; and number and size of families. The relation between these classifications and purchasing power is perhaps obvious. It is readily seen that a community made up largely of men and women between twenty and forty-five years of age would likely have a greater purchasing power than one com-

¹ Since 1930, governmental action has greatly influenced purchasing power of different classes of individuals. Thus large amounts in relief payments have been made to the unemployed; benefit payments amounting to hundreds of millions of dollars have been given to producers of cotton, rye, sugar beets, sugar cane, tobacco, peanuts, corn, wheat, and hogs; loans have been extended to manufacturers, farmers, home owners, banks, insurance companies, and railroads. The government has paid out huge sums for public construction, thus creating a demand for labor, machinery, and other supplies. At the same time the purchasing power of others has been decreased through added costs, higher taxes, and direct competition with more or less subsidized activities.

prising a large proportion of children and of aged people. A community comprised of retired business men or farmers might have a higher purchasing power than another community; however, sales might not be so great per capita owing to differences in living habits. Total and per capita purchasing power is likely to rise as we approach the condition of a stationary population; this situation is estimated for the United States by approximately 1950. There will be at that time a smaller proportion of children and of low-earning foreign laborers in our total population.¹ A population having a large percentage of negroes or of foreign-born laborers does not usually possess high purchasing power because of low incomes, yet it is stated that the consumption of poultry and eggs is affected in a positive way by the number of foreign-born, Jewish, negro, and transient inhabitants.²

Economic Activities.—One of the most satisfactory indexes of purchasing power is the nature of the economic activities carried on within the market area. Some cities and districts take on peculiar characteristics due to their predominating industry or activity. There are, for instance, one-industry towns, such as Bridgeport, Akron, Youngstown, Pittsburgh, and Gary, in which men workers predominate. Then there are the women's towns, such as New Bedford, Lowell, Patterson, Fall River, and Manchester, which are primarily dependent upon the textile industry. Other cities, because of excellent transportation facilities with the surrounding territory, become good shopping and distributing centers for a wide area. The purchasing power in such cases may depend upon the degree of agricultural or mining prosperity. The more diversified the economic activities of a district are, the more stable is the income of the community. Industries that have strong seasonal trends do not make for steady payrolls. Agriculture, for instance, is subject to seasonal variation in production, and, in addition, the income is subject to violent fluctuation due to weather conditions at home and trade conditions abroad. In spite of these handicaps, the agricultural population of the United States possesses great purchasing power.

Analysis of Purchasing-power Factors.—We can simplify our analysis of the purchasing power of the market by asking and answering a few illuminating questions: *viz.*, What are the sources of our national income? How do the amount and the buying power of the income vary from year to year? Who gets the national income, *i.e.*, what are the major income groups, and what proportion of the income goes to each group? Can we divide the recipients into family groups and classify them on an income basis? How is the income used; *i.e.*, what do the families in

¹ The change in the character of our population is due to the decline in the birth rate and in immigration.

² COWAN, D. R., *Analysing the Market for Poultry Products*.

the various income groups buy with their money, and how do their expenditures for major items vary with the size of the income?¹

Some Factors Affecting Purchasing Power.—The major objective of the consumer as a buyer is to satisfy, to the best of his ability, his varied wants and desires. His ability to fulfill his wants depends upon his awareness of his needs, his decision as to what product or service will suffice, and his ability to finance his proposed purchase. The ability and opportunity of a nation to consume are limited, in the long run, by its natural resources and its productive activity. A nation cannot long consume abundantly unless it produces in like manner.

The American industrial worker, for example, has enjoyed over a long period of time a better relative economic position than his brethren in other countries.² This favorable position has been made possible, in part, by our rich natural resources, the character of our population, and the aggressiveness of our business management. The American manufacturer makes great use of power equipment. More power and machinery per worker is constantly being used so that the output per man constantly increases, thus lowering production cost and at the same time permitting a shorter working day and higher wages to the laborer and lower prices to the buyer. The following table illustrates this development up to the beginning of the depression.

TABLE 1.—PRODUCTIVITY OF MANUFACTURING INDUSTRIES¹

Year	U.S. Population	Physical volume of production	Number of wage earners	Output per wage earner
1899	100	100	100	100
1909	121.1	154.5	130	118.9
1919	140.3	225.1	169.4	133.0
1921	144.5	186.3	136.2	136.9
1925	153.4	282.2	169.1	166.9
1929	162.3	331.4	164.2	189.7
Average yearly increase, per cent. . . .	2.05	7.0	2.1	3.0

¹ *Economic Conditions*, published by the National City Bank of New York, September, 1934.

² This question is discussed in Chap. III.

³ According to calculations made by the American Iron and Steel Institute, based on records of the U.S. Department of Labor and the League of Nations, steel-mill employees in the United States earn an average of 120 to 650 per cent more per hour than workers in foreign mills. American workers were paid an average of 64.7 cents per hour in November, 1934, compared with 17 cents in Belgium (1933); 22¾ cents in Czechoslovakia (1934); 26 cents in Germany (1934); 25 cents in Great Britain (1933); 9¾ cents in Japan (1933); and 29 cents in Sweden (1932). The unweighted average for these six countries is 20.6 cents per hour. *Milwaukee Jour.*, Jan. 29, 1935.

It is interesting to note that the output per worker increased continuously during the period even though there was considerable fluctuation in the physical volume of output during depression periods. During the period 1922-1929 the manufacturing industries of the United States secured an average increase of 3.8 per cent per worker per year. This was brought about largely through increased mechanical efficiency. The average yearly percentage increase in the number of workers was 2.1 per cent, which was practically the rate of increase in the population. The physical volume of production, however, increased 7 per cent yearly.

Aggregate profits of all corporations in the United States for the period 1919-1932 averaged 2.42 per cent of the aggregate gross income. If we eliminate the three worst depression years—1921, 1931, and 1932—the profits averaged 4.08 per cent of gross income. The average profit on gross business of manufacturing concerns for 1919-1932 was 3.62 per cent, and on net worth for 1924-1929 it was 3.95 per cent.¹ If these estimates are correct, profits were not excessive, nor was there overproduction of manufactured goods.

The ability to consume of any given family or individual within the nation depends upon the proportion of the national money income received. The individual in the role of a producer wishes to sell his own services for as great a portion of this money income as possible; as a consumer he wishes to exchange as small a portion of his money income for as large a quantity of goods and services as possible.

The following quotation from a letter written by Henry Ford to Matthew Woll, vice president of the American Federation of Labor, indicates the vital relationship existing between the ability and the opportunity of labor to sell its services at a price that will enable the workman to buy the goods of industry. The value of good management in modern industry is likewise emphasized.

Unless the worker in American industry is enabled to use and enjoy the products of industry, the natural balance cannot be maintained. Our only market is our people. I believe that wages will continue to go higher not as a result of politics or from purely humanitarian motives, but as the result of the kind of management that will enable men to earn more.

You understand, of course, that inexperienced or short-sighted management does not create the conditions under which men can earn more. Industry cannot pay men what they do not earn, but it can create methods by which men, with the same effort, or even less, can earn more and so receive more.²

The producer is in business for the purpose of supplying, either directly or indirectly, the wants of the consumer. The products of the farm,

¹ *Op. cit.*, November, 1934.

² *New York Journal of Commerce.*

the mine, the forest, and the waters are sent to market in response to, or in anticipation of, this consumer demand. Our great industrial and commercial centers have been developed in an attempt to serve the consumer. The numerous and varied educational, professional, and amusement agencies have come into existence as a result of the great consumer demand or in anticipation thereof. The purchases of industrial concerns are limited by current earnings, the prospects of future profits, and the availability of long-term credit.

The consumer, undoubtedly, holds a dominant position in our economic life. Upon his ability and willingness to buy depends, either directly or indirectly, the success of any given business enterprise. Producers, merchants, and the various agents and agencies are in business to earn a surplus above their costs. The amount of this surplus is limited by the prices they pay for labor, materials, equipment, power, and other requisites, and the prices they receive for the finished goods and services sold. As we noted above, the ability of the consumer to buy continuously in satisfactory quantities, at remunerative prices to the producers and merchants, depends upon his purchasing power—the size and proportion of his money income.

The student should not be misled, however, by the foregoing statement. Reflection will immediately demonstrate to him that consumers and producers cannot be permanently segregated into two distinct groups with, perhaps, conflicting and opposing interests. Producers and merchants are also consumers. The consumer is also a producer and a seller. The laborer, for instance, sells his services and buys goods and services. This dual relationship has caused much confusion in thinking on the part of many well-meaning people.

The Sources of Our National Income.—Table 2 indicates the importance of the various major divisions in our economic organization as sources of the national income. The data begin with 1929, the year of greatest total money income and of greatest total purchasing power.¹ If we group the various sources of income under the four corresponding headings used in classifying goods on the basis of their source, we have the following: agricultural, natural, manufactured, and service. The proportion of total income supplied by agriculture amounted to approximately 7.8 per cent in 1929. This percentage fell to about 6.75 in 1933, which, however, was slightly higher than the 6.75 per cent shown for 1932, the low point for agriculture. The share of the total furnished by the

¹ The adverse effects of the depression on the ability of these industries to produce and pay out income is clearly indicated in the declining figures for the years following 1929. Thus the income furnished by agriculture fell 50 per cent in 1933 when compared with 1929; construction, almost 75 per cent; manufacturing, almost 55 per cent; the average for all divisions, almost 43 per cent.

manufacturing industries was almost 23 per cent for 1929. The proportion from this source fell to approximately 18.6 per cent in 1933. The amount supplied by mining was not very large—approximately 2.65 per cent in 1929—and this small share fell to slightly more than 1.5 per cent in 1933. The total proportion of these three major groups fell from approximately 33.5 per cent of the gross national income paid out to

TABLE 2.—SOURCES OF OUR NATIONAL INCOME¹
(In millions of dollars)

Source	1929	1930	1931	1932	1933	1934	1935*
Agriculture.....	6,157	5,495	4,271	3,192	2,993	3,299	
Mining.....	2,080	1,733	1,206	813	772	1,008	
Manufacturing.....	18,014	15,942	12,363	8,544	8,273	10,000	
Service industries:							
Transportation and communication.....	7,505	7,075	6,063	4,884	4,474	4,742	
Electric light, power, and gas..	1,304	1,475	1,408	1,275	1,164	1,143	
Trade.....	11,385	10,839	9,555	7,538	6,620	7,177	
Finance.....	8,415	7,540	6,296	4,925	3,998	4,130	
Construction.....	3,257	2,939	1,969	948	781	869	
Personal, domestic, and professional service.....	8,459	7,979	6,939	5,442	4,884	5,412	
Government ²	6,809	7,048	7,193	7,153	7,377	8,404	
Miscellaneous.....	5,191	4,908	4,170	3,250	3,095	3,256	
Total income.....	78,576	72,973	61,433	47,964	44,431	49,440	
Percentage of 1929.....	100	92.9	78.2	61.0	56.5	62.9	

¹ *Survey of Current Business*, August, 1935. These figures represent the amount of the national income paid out. Estimates of national income vary considerably, owing to different methods used in evaluating services and in classifying different items. The Brookmire Service estimates the national income for 1929 at \$86,106,000,000; the Brookings Institution estimate, published in *America's Capacity to Consume*, is \$92,900,000,000; while the estimate of the Department of Commerce is \$82,300,000,000. Brookmire's estimate for 1933 is \$49,559,000,000 (preliminary estimate for 1934—\$55,107,000,000) and the Department of Commerce estimate for 1933 is \$46,800,000,000 (preliminary estimate for 1934—\$52,000,000,000). On the basis of the Brookmire estimate, income in dollars fell 42.4 per cent from 1929 to 1933, but the purchasing power of the income declined only 23.1 per cent.

² The amount paid out by the government includes relief, rental, and benefit payments made in 1933 and 1934. Work relief payments in 1933 amounted to \$637,000,000 and in 1934 to \$1,394,000,000.

* Figures for 1935 are to be supplied by the student.

approximately 26.85 per cent in 1933. The remaining items, furnishing 66.5 per cent of the total national income in 1929 and approximately 73 per cent in 1933, may be grouped under the heading Service. A more careful study of this group is necessary to determine what relative position the constituent members hold. We note immediately that the amount paid out by the government group was higher in 1934 than in 1929.¹

¹ When relief, benefit, and rental payments are included for 1934, the total amounts to about 17 per cent of the total income paid out.

Since the total income decreased almost 37 per cent, the proportion paid out by this group increased drastically—from slightly less than 9 per cent to about 17 per cent. The construction industry, on the other hand, moved in the opposite direction. The other major classes in the service group held approximately the same relative position in 1934 as in 1929, with the exception of the miscellaneous item, which reduced its payments more than the average. The reader should keep in mind, for future reference, the important positions, both relatively and absolutely, held by manufacturing, trade, finance, personal service, agriculture, and transportation and communication. Our general purchasing power is affected very greatly by the economic condition of these groups.

Purchasing Power and the Business Cycle.—Depressions, the devastating effects of which the present generation is painfully conscious, are characterized by unemployment and low purchasing power for the masses. Unbalanced production and consumption, together with rather thoughtless speculation in urban real estate, commodities, and securities, were the major causes of the depression of the 1930's. The foundation for the unfortunate situation was laid in the period 1914–1920—the period of speculation in farm lands and great expansion in industrial production facilities—to meet the demands of war. The situation was continued and aggravated during the 1920's largely through foreign loans to maintain international trade and liberal domestic credit to promote and extend sales at home.

Table 3, which states in percentages of the base year 1929 the income paid out by the major economic divisions, clearly demonstrates the loss of purchasing power on the part of farmers, industrial laborers, and other would-be purchasers during the period. This condition explains the loss of markets to thousands of would-be sellers. We, as a nation, are equipped to produce vast quantities of goods and services, but we cannot, as a people, consume them because of our lack of properly distributed purchasing power. Following 1929, the concept of purchasing power was greatly emphasized by the government and by the public. The New Deal legislation of the 1930's attempted to break the vicious circle by pouring purchasing power into the hands of the ultimate consumer in the form of relief and benefit payments and by means of loans, public works, shorter hours, higher wages, unemployment insurance, and old-age pensions. The avowed purpose of N.I.R.A.¹ was to increase the purchasing power of the wage earner and of industry generally; the A.A.A. and

¹ Abbreviation equivalents: N.I.R.A., National Industrial Recovery Administration; A.A.A., Agricultural Adjustment Administration; F.C.A., Farm Credit Administration; P.W.A., Public Works Administration; F.H.A., Federal Housing Administration; C.W.A., Civil Works Administration; F.E.R.A., Federal Emergency Relief Administration.

the F.C.A. were designed to increase the purchasing power of the farmer and those closely related to him; the purpose of the P.W.A. and the F.H.A. was to aid the construction industry; C.W.A. and F.E.R.A. were designed to give purchasing power to the unemployed and other needy individuals and families. The American dollar was devalued in an attempt to ease the debt burden of domestic debtors and to increase the purchasing power of foreign countries when buying American goods.

TABLE 3.—SOURCES OF OUR NATIONAL INCOME¹
(As percentage of 1929)

Source	1929	1930	1931	1932	1933	1934	1935*
Agriculture.....	100	89.2	69.4	51.8	48.6	53.6	
Mining.....	100	83.3	58.0	39.1	37.1	48.5	
Manufacturing.....	100	88.5	68.6	47.4	45.9	55.5	
Service industries:							
Transportation and communi- cation.....	100	94.2	87.86	65.07	59.6	63.18	
Electric light, power, and gas..	100	113.1	108	97.8	89.5	87.7	
Trade.....	100	95.2	83.9	66.2	58.1	63.0	
Finance.....	100	89.6	74.8	58.5	47.5	49.1	
Construction.....	100	90.2	60.5	29.1	24.0	26.7	
Personal, domestic, and pro- fessional service.....	100	94.3	82.0	64.3	57.7	64.0	
Government.....	100	103.5	105.6	105.1	99.0	103.0	
Miscellaneous.....	100	94.5	80.5	62.6	59.6	62.7	
Total.....	100	92.9	78.2	61	56.5	62.9	

¹ *Survey of Current Business, op. cit.*

* Figures for this column to be supplied by the student.

The prices paid for manufactured goods normally bought by farmers declined, during the depression, only about half as much as the prices received by farmers for the products they sold. Strenuous efforts were made to bring about a satisfactory and reasonable adjustment in the two price groups. It should be obvious to the student, however, that the creditor group and others on fixed incomes who have to pay more dollars for the same quantity and quality of services and goods have their purchasing power reduced by such measures. The net result is a shifting of purchasing power from one group to another without a real increase in total purchasing power. The payment of relief and the raising of wages and of the prices of certain favored commodities, when accompanied by a corresponding increase in retail prices, merely shift purchasing power from one group of citizens to another. This shifting, however, may greatly affect the consumption of many kinds of goods and services. The sales of necessities and semi-luxuries may increase, while the sale of

luxuries and high-priced articles may decline; the sales may increase in some localities and decline in others.

Purchasing power in the long run must come from production, yet production alone does not necessarily create or distribute purchasing power in an equitable manner. If the goods produced are not exchanged for money or other goods, no purchasing power develops. One fact is self-evident—there must be an exchange eventually of goods for goods. Money merely facilitates the transaction.¹ The purchasing power of the dollar declines when prices rise; consequently, the buyer must possess more dollars in order to command in exchange the goods and services he is accustomed to use. The per capita income in 1913, for example, was \$382; in 1920 the per capita dollar income had risen to \$707, yet in terms of 1913 purchasing power the real income was only \$357, or \$25 less than in 1913; in 1926 the per capita dollar income was \$735, but in terms of 1913 purchasing power it was \$442. Thus while the dollar income had risen \$28 between 1920 and 1926, the purchasing power had risen \$85—the result of declining prices. By 1929 the per capita dollar income was \$755, while in terms of the 1913 purchasing power the income was \$473. During 1927, 1928, and 1929 the purchasing power of the dollar rose slowly; beginning with 1930 and continuing into the first half of 1933, the buying power of the dollar increased drastically; following this latter period the power of the dollar declined.

Chart I, which presents the wholesale prices of farm products, foods, all other commodities, all commodities combined, and the resulting purchasing power of the dollar in terms of the wholesale prices of all commodities, illustrates in a striking manner the relationship of prices and purchasing power. The high prices resulting from the inflationary war period, together with the drastic decline in purchasing power, are vividly portrayed. The price of food products did not, it will be noted, rise as high as the prices of other commodities. The peak in the prices of agricultural products was reached approximately a year before the high point for all commodities other than farm products and foods. All prices fell to the bottom at about the same time and at about the same rate of decline. The various price lines in 1933 are in the same general position as they were in 1913—twenty years earlier. The positions of individual price lines are different. The prices of agricultural products in 1932 and 1933 were considerably lower than they were in 1913 and 1914. In the latter years they were above the prices of food products and all commodities other than food; in 1932 and 1933 the spread among the lines was much greater, and agricultural prices were approximately ten points below the next lowest line. It is worth while to note the stability and the uniformity of relationship that existed during the period 1922–1929.

¹ Cf. BORSDI, R., in *Advertising and Selling*, Oct. 25, 1934.

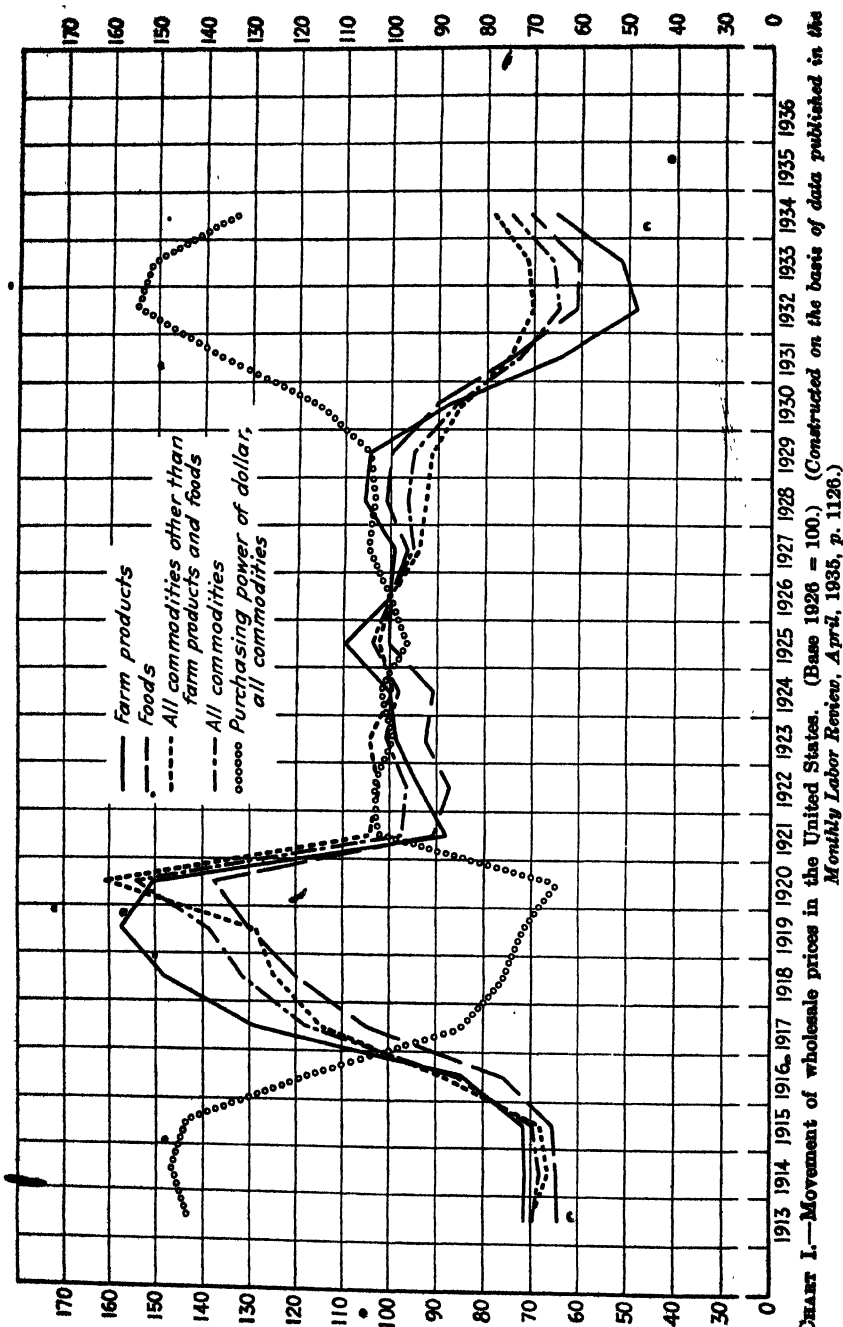


CHART I.—Movement of wholesale prices in the United States. (Base 1926 = 100.) (Constructed on the basis of data published in the *Monthly Labor Review*, April, 1935, p. 1126.)

Relationship between Prices and Purchasing Power.—The following instances demonstrate how a declining price level increases the purchasing power of the buyer and thereby increases the consumption of the particular product. Copper at one time sold for 45 cents a pound, silk at \$9 a pound, electricity at 25 cents a kilowatt, and safety razor blades at 10 cents each. If the buyers of automobiles in 1933 had paid the prices prevailing in 1914, the total bill would have been \$600,000,000 more than it was. The amount paid for electric power in 1933 would have been \$1,400,000,000 additional if the 1909 rates had been in effect. If the 1870 freight rates had been in force in 1933, the bill would have exceeded that actually paid by \$2,500,000,000. It seems logical to assume that the great increase in consumption is made possible through the substantial reduction in prices. Thus people with lower incomes were able to buy merchandise and services which formerly could be purchased only by those in the higher income brackets. The reduced prices were made possible chiefly through large-scale production and other technical improvements.

Distribution of the National Income.—The ability to consume abundantly and the opportunity to produce profitably are greatly influenced by the extensiveness of the distribution of the national income. Two communities having populations of the same size might enjoy total incomes equal in amount; if 95 per cent of the income in the first locality was received by 5 per cent of the population, while the income in the second was apportioned more uniformly, the opportunity to consume equally abundantly would be much less in the first instance than in the second.

A knowledge of the total income gives valuable information with reference to general purchasing power. This information is sometimes more useful when stated in terms of per capita, per worker, or per family income. It is desirable, at other times, to know how the total income is distributed according to groups. In this way the seller can measure his market more accurately with reference to products in different price ranges.

The kind, quality, and amount of merchandise and services that can be purchased by an individual, a family, or a community are obviously limited by its money income. Thus if a very large proportion of the community income is received by workers in the form of wages, and a relatively small proportion goes to the owners of wealth in the form of profits, rent, and interest, there will be a large market for food, clothing, shelter, and semi-luxuries. It has been said that every worker constitutes a potential market for all that he can earn. If a large proportion of the income, on the other hand, goes to a relatively small group of wealthy people, the character of the market will be greatly changed.

To know, for instance, that the per worker income of a certain city is \$1,439 does not aid a manufacturer in evaluating the place as a market for a \$5,000 automobile. It is necessary, in such a case, to determine what income group can afford to buy this priced car and then determine the number of people in the group.

The population of the United States comprises people who are employed by others for wages and for salaries; owners of property, who secure an income for their own services and from profits, interest, rents, royalties, and dividends; and professional people, who receive an income in the form of fees for their services.

• TABLE 4.—DISTRIBUTION OF THE NATIONAL INCOME¹
(As percentages of total income produced)

Employees				All others ²				
Year	Total ³	Wages	Salaries	Total	Agricultural	Non-agricultural ⁴	Investors and property holders	Business savings
1909	54.4	38.8	15.6	45.6	12.6	13.6	14.7	4.7
1914	57.4	38.4	18.0	42.6	10.5	14.5	15.8	1.8
1919	55.4	36.1	18.1	44.6	14.3	11.2	12.3	6.8
1924	63.6	41.5	20.3	36.4	8.1	13.0	13.2	2.1
1925	61.7	40.5	19.8	38.3	8.4	12.6	13.5	3.8
1926	63.8	41.8	20.5	36.2	7.1	12.1	14.1	2.9
1927	64.6	41.3	21.7	35.4	7.4	12.3	14.4	1.3
1928	63.5	40.0	22.1	36.5	6.8	12.1	14.6	3.0
1929	65.1	42.1	21.7	34.9	6.8	10.5	14.9	2.7
1930*	64.2	....	....	35.8				
1931	64.2	....	....	35.8				
1932	63.9	....	....	36.1				
1933	65.5	....	....	34.5				
1934	67.0	....	....	33.0				

¹ Adapted from Leven, Moulton, and Warburton, *America's Capacity to Consume*, p. 158, The Institute of Economics, The Brookings Institution, Washington, 1934.

² Includes pensions, workmen's compensation, etc.

³ Includes return on owned capital as well as "labor income" of entrepreneurs.

⁴ Interest, dividends, rents, and royalties.

* Years 1930, 1931, 1932, 1933, and 1934, *Survey of Current Business*, pp. 17 f., Aug. 1935. The figures are not exactly comparable with those for the preceding years since certain adjustments were made in the study by the Brookings Institution that were not made in the Department of Commerce Report. The figures for 1933 and 1934 include 1.4 and 2.8, respectively, for work relief wages.

The group that works for others on a wage or salary basis comprises a larger number of people than all the others combined. Table 4 shows that the members of this class received 54.4 per cent of the total national income paid out in 1909; the remaining 45.6 per cent went to all the other

recipients, 12.6 per cent going to agriculture, 13.6 per cent to non-agriculture, 14.7 per cent to investors and property holders, while 4.7 per cent represented business savings. Wage earners received 38.8 per cent of the total, and those on a salary received 15.6 per cent. The proportion going to the employee group had increased to 65.1 per cent by 1929, while the share of the other recipients had fallen to 34.9 per cent. The wage-earning group and the salary group both benefited relatively at the expense of the others. The income of the agricultural group fell to 6.8 per cent, and that of the non-agricultural group declined to 10.5 per cent; the income of investors and of property holders remained practically the same—there was a slight rise of two-tenths of 1 per cent; and business savings fluctuated directly with business conditions. Table 4 presents this information in more detail for the period 1909–1929.

There was a slight decline in the proportion going to the employees during the depression. The total income paid out in 1933 was approximately 57 per cent of the amount paid out in 1929. This smaller payment obviously reduced greatly the purchasing power of the country since prices did not fall correspondingly low. Owing to the fact that so many business enterprises were not able to cover their costs of operation from earnings in 1932, they paid out large sums of money in the form of wages and other expenses from their accumulated surpluses. Thus it is estimated by one authority that the amount *paid out* in the form of wages and salaries in 1932 amounted to 80.1 per cent of the total national *income produced*. All others received but 19.9 per cent of the produced income for that year. The purchasing power of the individual did not decline as much as the percentage of money paid out. While the total income paid out declined 43 per cent from 1929 to 1933, the cost-of-living index of the National Industrial Conference Board declined 25 per cent. Thus a portion of the decline in income was compensated by the decline in the price of goods purchased.

Family Incomes.—A very large proportion of consumer goods is purchased on a family basis. The ability of a given family to consume abundantly, as we have noted, is limited by its income. The higher the family income, the more goods and services will be consumed.¹ The larger the number of families receiving incomes above the bare subsistence level, the greater will be the total demand and, consequently, the sale of goods and services.

There were approximately 27,500,000 families of two or more persons in the United States in 1929.² How much of the total national income

¹ This is on the assumption that there is not a corresponding increase in prices.

² *America's Capacity to Consume*, *op. cit.*

There were, in 1929, 2,351,000 persons classified as families because they maintained individual living quarters and 6,637,000 income-receiving individuals living

distributed that year did each family receive? Table 5 presents an enlightening summary and analysis of family incomes for the year. During periods of great economic upheaval and readjustment, such as the years following 1929, radical changes, no doubt, occur in the size and composition of these various income groups. The snapshot view presented by this table, however, may indicate the normal distribution of

TABLE 5.—THE NUMBER AND INCOME OF FAMILIES BY INCOME CLASSES, 1929¹

Income class, dollars	Total in each class			
	Families ²		Income ³	
	Thousands	Percentage of total	Millions of dollars	Percentage of total
Up to \$1,000.....	5,899	21.471	2,900	3.761
\$1,000 to 2,000.....	10,455	38.054	15,364	19.923
2,000 to 4,000.....	7,632	27.743	20,974	27.198
4,000 to 6,000.....	1,898	6.908	9,110	11.813
6,000 to 10,000.....	959	3.490	7,188	9.321
10,000 to 25,000.....	471	1.715	6,831	8.858
25,000 to 100,000.....	136	0.495	5,996	7.775
100,000 and over.....	24	0.088	8,753	11.351
All families ⁴	27,474	100.000	77,116	100.000

¹ Adapted from *America's Capacity to Consume*, *op. cit.*

² All families of two or more persons.

³ Includes income from occupation, investments, and sale of property; also includes imputed income on owned homes but does not include imputed income on durable consumption goods other than homes.

⁴ There were in addition 8,988,000 non-attached individuals who received \$15,834,000,000 in 1929. The median income for this group was \$1,760 per capita. These income figures include some "imputed" income, so the total is higher than figures giving the "produced" national income.

income under a more or less stabilized condition. This statement, however, is a mere conjecture and should not be taken too seriously by the reader. It cannot be determined at this time what effect a governmental attempt to control this distribution will eventually have on our economic organization. The figures in the table indicate only too clearly the large number of families that were forced to low standards of consumption due to inadequate income.

Almost 21.5 per cent of the total number of families received \$1,000 a year or less and secured only 3.76 per cent of the total national income.

outside family groups. These groups received incomes in 1929 amounting to almost \$16,000,000,000. The number of income-receiving family units was thus about 36,462,000. *Ibid.*, pp. 51 f.

The total number of individual income recipients in 1929 was 49,041,000. *Ibid.*, p. 233.

paid out. The \$1,000 to \$2,000 a year group received the large sum of \$15,364,000,000; yet this was slightly less than 20 per cent of the total amount paid out, while the group comprised slightly more than 38 per cent of the total number of families. Thus 59.5 per cent of the families received \$2,000 a year and less and slightly less than 23.7 per cent of the income. Almost 51 per cent of the total income was paid to families receiving \$4,000 and less a year. The percentage of families falling into

TABLE 6.—DESCRIPTIVE CLASSIFICATION OF THE 1929 POPULATION ON BASIS OF INCOME¹

Descriptive groups	Number ²	Percentage of total population	Income, billions of dollars	Percentage of total income
Wealthy:				
a. \$25,000 and over.....	160,000			
b. \$15,000 and over.....	66,000	0.62	18.3	19.69
Well-to-do:				
a. \$10,000 to \$25,000....	471,000			
b. \$5,000 to \$15,000.....	241,000	1.95	8.7	9.36
Comfortable:				
a. \$5,000 to \$10,000.....	1,625,000			
b. \$2,500 to \$5,000.....	632,000	6.19	12.9	13.89
Moderate circumstances:				
a. \$3,000 to \$5,000.....	3,672,000			
b. \$1,500 to \$2,500.....	1,900,000	15.28	17.5	18.84
Minimum comfort:				
a. \$1,500 to \$3,000.....	9,893,000			
b. \$750 to \$1,500.....	3,649,000	37.15	24.6	26.49
Subsistence and poverty:				
a. Under \$1,500.....	11,653,000			
b. Under \$750.....	2,500,000	38.81	10.9	11.73
Totals.....	36,462,000	100.00	92.9	100.00

a. This group comprises families of two or more persons.

b. This group comprises unattached individuals.

¹ Adapted from *America's Capacity to Consume*, op. cit., pp. 87-88.

² Number of families and unattached individuals (see a and b).

this group was 87.3 per cent of the total. We find at the other end of the scale that less than six-tenths of 1 per cent of the families receive slightly more than 19 per cent of the income. This group enjoys an annual income of \$25,000 a year and up. These figures show considerable concentration of income in this group. The median family received an income of \$1,700.

If the total income received by all families could have been divided equally among them, each would have received approximately \$2,800.

This equalized distribution would have affected in different ways the demand for various products. The demand for high-priced automobiles, furniture, and homes and for many forms of services would have disappeared. This change would have affected adversely the purchasing power of many firms and individuals. The demand for medium-priced goods and services, on the other hand, would have been greatly increased. The families in the lower income groups would have been able to buy more goods and merchandise of better quality. This increased demand would have favorably affected the purchasing power of a large number of firms and individuals supplying goods and services which this class could not otherwise afford.

Table 6 groups the families and unattached individuals under descriptive headings. Families receiving an annual income of \$25,000 and more a year and individuals outside family groups receiving \$15,000 and more a year are designated Wealthy. It will be noted that this group comprises only 0.62 per cent of the population but receives 19.69 per cent of the total income. There is only one other group, Minimum Comfort, which receives a larger proportion of the total income. It contains, however, 37.15 per cent of the population. The Subsistence and Poverty group contains the largest portion of the population, 38.81 per cent, yet it receives only 11.73 per cent of the income. A very large number of families in this group receive an annual income far below \$1,500. While a family of two might live with comfort on \$1,500 in a given community, the same family living in another community might find \$1,500 inadequate; again, a family of six would find \$1,500 insufficient in almost any urban community to furnish the necessities of life. An unattached individual, however, could live comfortably on this amount in the average city.

SUMMARY

The problem of determining the purchasing power of any given market is indeed a difficult one. Since we do not know the amount, source, and degree of stability of the income of each buyer or the people who constitute a given market, we have to resort to estimates. It is necessary to establish indexes of various kinds which are only rough approximations. We do not know very accurately *how much* income families in a given market receive or spend; *where* they get it and for *what* they use it; *when* they receive their money and *when* they spend it. Our knowledge of incomes is better than formerly, but our knowledge of family budgets is still very meager. Recent and proposed studies by various governmental agencies promise valuable information along this line. The following outline summarizes the type of information that must now be used in attempting to appraise the purchasing power of a given market.

FACTORS INDICATING MARKET POTENTIALITIES¹

1. Population factors:
 - a. Population.
 - b. Number of families.
2. Wealth factors:
 - a. Value added by manufacture.
 - b. Value of crops.
 - c. Value of fishery and live-stock products.
 - d. Bank deposits.
3. Standard of living factors:
 - a. Income-tax returns.
 - b. Home tenure.
 - c. Number of residence telephones.
 - d. Total population with electricity available (total number of homes wired for electricity).
 - e. Number of domestic customers using electricity.
 - f. Number of domestic customers using gas.
 - g. Number of new passenger automobile sales.
 - h. Magazine circulation.
4. Market outlets:
 - a. Number of wholesale outlets.
 - b. Number of retail outlets.

References

- BREYER, R. F., *Marketing Institutions*, Chap. 5, "Marketing under Varying Conditions on the Deficit Side of Markets"; Chap. 7, "Marketing under Varying Conditions on the Surplus Side of Markets"; Chaps. 11, 12, "The Marketing Institution and Competitive Conditions"; Chap. 14, "Acquisitive Efficiency"; Chap. 15, "Social Effectiveness: Estimating the Marketing Situation."
- CROSSLEY, A. M., *Watch Your Selling Dollar*, Part III.
- KILLOUGH and BARRINGTON ASSOCIATES, *The Economics of Marketing*, Chaps. V, VI, VII, XXIV.
- LEVEN, MOULTON, and WARBURTON, *America's Capacity to Consume*.
- NOURSE and ASSOCIATES, *America's Capacity to Produce*.
- U.S. Department of Commerce, "Measuring a Retail Market," *Trade Information Bull.* 272.
- References cited in footnotes.

Questions for Discussion

1. "Although income is computed in terms of money, all real income is in goods or services." What is the social and economic significance of this situation?
2. Can there be a market for a non-existing good? Justify your answer.
3. "The total 'national income' produced fell from \$83,052,000,000 in 1929 to \$39,365,000,000 in 1932, while the total national 'income paid out' fell only from \$81,736,000,000 to \$48,864,000,000." How did this situation affect the consumption of goods and services? What were some of the problems presented to (a) producers, (b) consumers, (c) merchants?

¹ "Market Data Book of New England," *Domestic Commerce Ser.* 24, p. 4. Wholesale and retail sales are additional factors now available.

4. Draw up a definition of a market. Explain the function of the market, as you have defined it, in industrial society.

5. What effect would an extension of the area of the market be likely to have on functional division of labor? On territorial division of labor? What are the major physical limitations to the extension of the market area?

6. Draw up as many types of classifications of markets as you can. In each case point out the basis upon which the classification rests.

7. "Commodities for which there is a very wide market must also be such as will bear a long carriage: they must be somewhat durable, and their value must be considerable in proportion to their bulk. A thing which is so bulky that its price is necessarily raised very much when it is sold far away from the place in which it is produced must, as a rule, have a narrow market." Give illustrations of such commodities. How may the market for bulky commodities be extended?

8. "No amount of competition among retailers can increase the total consumption buying in a community unless the community as a whole increases its income or reduces the proportion of its income which it usually saves." What bearing does this fact have upon "demand creation" activities?

9. "Thus the character of the markets varies with the area of Space over which they extend; but it varies even more with the length of Time of which account is taken; and we shall find that, if the period is short, the supply is limited to the stores which happen to be at hand; if the period is longer, the supply will be influenced by the cost of producing the commodity in question; and if the period is very long, this cost will be influenced by the cost of producing the labor and the material things required for producing the commodity." Give illustrations showing how the varying time element affects the supply in specific instances.

10. "At whatever point transfers in the ownership of goods are effected there is a market." Is the market a particular place? A particular time? Must the goods be present?

11. "It is a commonplace of industrial history that improved transportation makes possible larger markets, large-scale production, and specialization in industry; that it has increased the variety of goods available for consumption and has reduced the cost of their physical distribution." Give instances illustrating these points.

12. "There is a world market for grain. Japan is a good market in which to buy silks. A free-trade nation offers a good market for certain commodities." What conception of a market is implied in these quotations?

13. What is meant by the term "ruling market"? Where are the ruling markets for wool, copper, wheat, coffee, cotton? In each case, why? Can you locate any other ruling markets?

14. "In the true ruling market which is not the place of supply but the place of principal demand, the delivered price is independent of tariffs." Demonstrate by illustrations the truth of this statement in the case of sugar imported from Cuba into the United States.

15. "The attributes of a competitive market are (a) a common meeting place, (b) common knowledge of market information, (c) indifference to identity of product." Why are these elements necessary attributes of true competition?

16. Is it possible, under the existing economic system, to enable the poorer classes to purchase enough so that the consumer market as a whole will be able to absorb all that our factories can produce? What factors in general affect the sale of goods, e.g., foodstuffs, clothing, automobiles, radios, steam yachts, toy balloons, candy, tractors, wagons, bicycles?

17. "The market, in the case of wheat, is at Chicago, even though the producers are located outside, because it is a buying market. The market, in the case of steel,

is at Chicago even though the consumers are located outside, because it is in that case a selling market." What is the difference between a *buying* and a *selling* market?

18. It should be noted that manufacturers need many specific items of information about their market before they can either determine upon the proper price or decide wisely on later price changes. What are some of the more specific items?

19. "Many mistakes have been made by manufacturers who have not known where their market was to be found." Does this lack of knowledge injure the manufacturer, the middleman, or the public?

20. What is the logical attitude for private capitalism to assume toward poverty? Justify your answer.

21. If it is proposed to increase real national income 20 per cent and to place 83 per cent of this increase, through wage increases, in the hands of families with less than \$3,000 a year, what will be the nature of the resulting consumer demand? How will it be distributed among commodities, *i.e.*, housing, transportation, and recreation; clothing, food? Will the increases in expenditures be of the same sort for all goods in a given class? How will the demand for quality and for quantity be affected?

The following four statements are part of the general conclusions reached in the study *America's Capacity to Consume*. Read each statement carefully, state whether you agree or disagree, and then justify your answer.

22. During the so-called "new era" of the gay twenties the United States was not living beyond its means.

23. There has been a tendency, at least during the last decade or so, for the inequality in the distribution of income to be accentuated.

24. The United States has not reached a stage of economic development in which it is possible to produce more than the American people as a whole would like to consume.

25. We cannot materially shorten the working day and still produce the quantity of goods and services which the American people aspire to consume.

CHAPTER III

BUYING MOTIVES, CUSTOMS, AND PRACTICES

Purpose of this chapter: To analyze the nature of consumer and industrial demands; to discuss some of the distinguishing characteristics of demand; to note how buying behavior is influenced by certain psychological factors and by the size of income.

We have learned that the sale-purchase contract requires purchasing power in possession of the buyer and some article of merchandise or form of service under the control of the seller. This situation alone, however, would not necessarily lead to a marketing transaction. There must be, in addition, a *willingness* to buy and sell. The willingness or mood to buy, for example, is greatly influenced by general economic and social conditions. Assuming that the family or individual possesses purchasing power and that a satisfactory economic good is available, purchase may be delayed while the prospect is waiting for lower prices, different models, or "to see what is going to happen." Purchases may, on the other hand, be increased if the buyer thinks, for example, that prices are likely to advance soon or that future models may be made of inferior materials. The willingness of the producer and the merchant to buy a particular good at any given time is governed largely by the possibility of making a profit, preventing a loss, or creating and maintaining goodwill.

The Ultimate Consumer.—The consumer buys to satisfy his personal needs and desires. It has been said that "everybody wants a little of everything and not much of anything." This leads, naturally, to much small-unit and wide-variety buying. Merchants and producers have been forced to adjust themselves to this practice of the public. Much concern for the consumer has been expressed by various sympathetic and well-meaning individuals. These people contend that the consumer needs protection from the aggressive selling tactics used by some manufacturers.¹ The consumer as an individual, it is thought, is not in a position to secure the necessary information about sources of supply, prices, and qualities in order to bargain on an equal basis with the seller.

¹ Many arguments point out that he needs protection likewise from his own weakness, ignorance, and lassitude.

While it is true that the consumer needs protection against any practices of adulteration of quality and against false branding and other dishonest and fraudulent methods of selling, he is not, perhaps, so helpless as some people contend.

The consumer determines, within more or less definite limits, the kind, quantity, and style of goods produced, the prices charged, and the services rendered. • The consumer seems to be exercising more and more control over the producers and the sellers. The seller may be able to educate, inform, and, to a certain extent, guide the consumer in his purchasing, yet it is clearly evident that the buyer today is more self-reliant and independent than ever before; he is more of a judge, a *chooser* from among what is offered than a spineless *accepter* of whatever it may suit the fancy or the convenience of the manufacturer or importer to thrust upon him.

The effective coordination of production and demand requires as a basis a knowledge of the buying behavior of the consumer. The securing of this information is no simple and easy task. Buying habits and customs change as conditions of living change. Eating habits, methods of recreation, habits of dress and travel, to mention only a few, have changed greatly during the last thirty years. More packaged goods and less bulk goods are bought; more emphasis is placed on style in clothing; more green fruits and vegetables are consumed out of the local season; and more time is consumed by the individual and the family for travel and recreation, thus creating a huge demand for many articles unknown to our grandparents. People tire of the old and want the new.

The volume of purchases of non-durable consumer goods is relatively constant, but that of durable consumer goods fluctuates violently during periods of depression. Consumers develop certain definite buying habits with reference to different goods and services. When buying some goods, of a durable or semi-durable character, the consumer usually wishes to compare and contrast the price, style, and quality of various articles of merchandise found in different stores. When buying certain other goods, he may be willing to depend on the reputation of the particular brand or of the merchant. The consumer has been convinced, in such instances, that the desired good is what he wants, so there is no necessity for him to compare quality, style, and price. He is willing to go "out of his way" to secure this particular brand or model of merchandise. A third set of habits has been developed in connection with the purchase of a large group of non-durable goods of a staple character. The buyer believes that there are a number of different brands or items that are equally good. He wants to find such articles of merchandise in a convenient location; he does not find it necessary or desirable to "go looking"

for such articles. Merchants selling these articles cater to these buying characteristics by providing convenient locations.

The importance of a knowledge of *why, when, where, and how much* the consumer can and will purchase is suggested by G. C. Smith,¹ who made the following statement:

Of all unknown factors in marketing, lack of detailed knowledge of the consumer is most serious. . . . It weakens personal sales work, permits us to put too much sales effort in one territory and too little in another, it allows us to direct our advertising through the wrong media, it leads us to make the wrong advertising appeal, it even results in our producing the wrong goods or distributing the right goods in the wrong way.

The producer or merchant who performs the greatest social good and at the same time lays the foundation for his own business success is the one who produces and offers for sale *what* the buyer wants, *at the time* he wants it, *at the price* he is willing to pay, together with the *quantity* and *quality of service* he desires.²

Consumer Demand.—Consumers buy merchandise and services as a means to an end. The end is to secure *satisfaction* through using or possessing that which is bought. People spend large sums of money for "emotional" satisfactions, *e.g.*, the purchase of rare works of art, antiques, stamps, tickets to musical programs and athletic contests; dining at expensive clubs; wearing distinctive clothes; living in exclusive hotels and residential districts; and the conspicuous consumption of a number of other economic goods. A study of *why* purchases are made is in reality an analysis of buying motives. Different motives may and do govern the actions of different individuals at the same time and under the same or similar circumstances; again, different motives may and do govern the actions of the same individual at different times and under different conditions.³

According to W. B. Pitkin, man is not a volume consumer first and foremost, but rather a sleeper, a singer, a lover, a dancer, an adventurer, a reader, a chatterbox, and a hundred other things at heart. He is much

¹ Formerly advertising manager, Libby, McNeill, & Libby.

² Mr. Weaver, of General Motors, has made a real contribution in the technique developed for studying the wants of consumers with reference to motor cars.

³ One adviser of high-school girls recommends spinach because "it is good for your complexion." "If you want pep, eat milk and eggs; spinach and milk for popularity and pep; apples for beauty."

To sell gas and gas appliances to the consumer one company made its appeal on the basis of "human comforts," *e.g.*, "well-cooked food, luxurious hot water, thrifty refrigeration, carefree home heat, increased leisure, and decreased drudgery, instead of trying to sell hardware, gadgets, and enamel finishes." Advertisement by N. W. Ayer & Son, Inc., in *Printers' Ink Weekly*, July 27, 1933.

more than an economic animal, more than a social constituent, more than an individual mind, more than a prospective buyer of goods. He is an enormously complex individual caught up in the web of life.¹

Elastic and Inelastic Demand.—The psychologist and the statistician have found, however, that, if a large group of individuals of approximately the same social class living under similar conditions are considered, a large proportion of them will display a high degree of similarity in their desires and in the methods they use in attempting to satisfy these desires. It is this attempt on the part of the buyer to secure satisfaction that makes him willing to buy. This willingness to buy, together with "ability" to buy, is labeled *demand* by the economist. The amount that people will buy at any given time depends, usually, upon the price asked for the goods. The higher the price of an article, generally speaking, the fewer people there will be in a community who will "stand ready" to buy; while the lower the price, the more people there will be "able and willing" to purchase. Again, the higher the price for certain kinds of goods, the smaller the number of units the individual will buy; and the lower the price, the larger the number of units he is likely to buy. If the amount which purchasers will buy changes considerably with every change in price, demand is said to be *elastic*. If the amount purchased changes only slightly with considerable changes in price, *e.g.*, if the amount which buyers would be willing to take increases very little with a considerable fall in price, or vice versa, the demand is said to be *inelastic*.

The idea of elasticity and inelasticity of demand may be stated also in terms of the total amount of money that will be spent at any given price for a designated good. Thus if the total amount spent by purchasers remains the same irrespective of changes in price, the elasticity of demand is said to be equal to unity.² For example, assume the following situation: At 50 cents a piece, 100,000 units of a given article can be sold in a specified period of time for a total sum of \$50,000. At \$1 a piece, 50,000 units can be sold for a total amount of \$50,000; at \$2 a piece 25,000 units can be sold for \$50,000.

When the degree of elasticity is less than unity we have what is termed an inelastic demand. Higher prices cause buyers to make greater total expenditures under this situation, but the total number of units purchased declines much less than in the first illustration. The following simple illustration makes this fact clear.

At 50 cents a unit, 100,000 units will be purchased at a total outlay of \$50,000; at \$1 a piece, assume that 90,000 units will be sold at a total outlay of \$90,000; at \$2 a piece, 60,000 units will be purchased at a total

¹ *The Consumer—His Nature and His Changing Habits.*

² Cf. WAUGH, A. E., *Quarterly Journal of Economics*, No. 1, pp. 134f., November, 1932.

cost of \$120,000. The inelasticity of demand is expressed by two indicators in this illustration. The radical change in price did not reduce purchases correspondingly, and the total outlay increased as the price rose.

When the degree of elasticity of demand is greater than unity we have an elastic demand. Under this situation higher prices produce smaller total unit purchases and smaller outlays, while lower prices, obviously, tend to promote greater total outlays. For example, assume that

at 50 cents, 100,000 units are sold for a total of \$50,000;

at \$1, 40,000 units are sold for a total of \$40,000; and

at \$2, 15,000 units are sold for a sum of \$30,000.

Here we find higher prices producing lower unit sales and a smaller total income; on the other hand, at 35 cents a unit it might be possible to sell 200,000 units for a total of \$70,000.

The consumer is much concerned with what he gets for the amount he pays.¹ The demand of an individual for certain commodities, such as bread and simple articles of clothing, might be inelastic, while the *market demand*—the demand of a large group of individuals—might be elastic. This would be especially true if the group were large enough to include people lower down the economic scale who would be willing to buy only at a substantially lower price.

The sales of automobiles, radios, washing machines, mechanical refrigerators, and other electrical appliances have been greatly extended by reducing the prices to such an extent that large groups of new buyers were reached—people who could not buy at the original higher prices.

The Law of Diminishing Utility.—While it is true that human wants are almost limitless in number, yet it is equally true that a person may get enough and more of a particular good to satisfy his wants. Since a consumer spends his money in an attempt to secure the greatest amount of satisfaction, he will tend to vary his selections so as to avoid the effects of the "law of diminishing utility." This so-called law, briefly stated, follows: As an individual consumes successive units of any one article, service, or pleasurable activity during one relatively short period of time, a decreasing amount of satisfaction is secured from the consumption of each additional unit. Thus the buyer might get a great amount of satisfaction from his first radio, automobile, or piece of watermelon, but the second, third, and other units of the same kind, make, style, size, color, and quality, bought in immediate succession for immediate personal use,

¹ Desire is the motive force that causes the consumer to select one kind of article or service in preference to another kind; to choose one brand or style instead of others; to work harder or longer, to save from his current earnings, and to borrow or in other ways secure control over purchasing power.

would cease to give the proportionate amount of satisfaction secured from the use of the first unit. The utility or the capacity of successive units to bring satisfaction may decrease to the point where displeasure and even pain results. Thus if a person should continue to eat successive servings of ice cream he would soon reach the point of satiety and, if he persisted in eating, reach the pain stage.

Economical Consumption.—The customary practice of intelligent consumers is to cease using units of one form of an article or service as soon as the satisfaction they anticipate from its utilization sinks below the amount of satisfaction they anticipate they would receive from the consumption of some other. This statement assumes that the various commodities sell for approximately the same price; otherwise they would not be on a comparable basis from the purchaser's point of view. Economical consumption, therefore, is *balanced consumption* in which the buyer receives the greatest amount of satisfaction by combining his purchases of food, clothing, shelter, recreation, education, and what not in such a manner as to decrease the effect of the law of diminishing satisfaction. It is obvious that purchasers who buy for resale, for industrial concerns, or for institutions are not subject to this law of diminishing satisfaction because they are actuated by entirely different motives.

Why People Buy.—People buy goods and services to satisfy some desire or physical need. There are personal needs that are supplied by food, clothing, housing, and the like; there are needs that arise from the occupation or profession of the individual, such as the needs for tools, libraries, and special kinds of clothing.

Climatic conditions are the source of the demand for many types of goods and services. The amount and frequency of rainfall influence the demand for raincoats, lawn sprinklers, drainage systems, and many other products. The extremes and frequency of variation in temperature are another cause of special needs for many articles peculiarly suited to overcome these situations. Electric fans, ice, fuel, furnaces, heavy clothing, tropical-weight clothing, and hot-weather foods serve to illustrate the products that fall into this group.

The nature of the topography of the country is another source of demand for special goods. The nature of the industries, occupations of the people, the density of population, as well as the prosperity of the locality, are determined to a considerable extent by whether the territory is mountainous, hilly, or rolling; whether it is a plain or prairie; and whether it has harbors, navigable streams, and lakes.

A study of the physical needs of a market and an examination of the occupational, climatic, and topographical characteristics will give a basis for judging the demand for certain kinds of goods. This type of analysis falls short, however, in that it does not explain why certain people will

"demand" food, clothing, and shelter of different qualities, amounts, design, and prices. In other words, the psychological aspects of demand are not covered.

Psychological Aspects of Demand.—This is not the place to indulge in a scholarly discussion of the various philosophies of life or to present a critical analysis of the different theories that attempt to explain and interpret human behavior. Our purpose will be adequately served by presenting some of the commonly accepted explanations of the more basic motives that govern people when they buy. Consumer buying motives are composites comprising a mixture of the influences of sex, age, race, religion, education, marital status, social standing, and manner of living, yet if a large homogeneous group is examined, a definite tendency for consumers to exhibit similar attitudes, habits, beliefs, misconceptions, wants, desires, and cravings will be found. The reason for these similar reactions seems to be that there are certain inherent mental traits or characteristics due to either inheritance or environment, or a combination of both, which are more or less common to the human species.

Inherent Human Wants.—Every human being possesses a number of native wants,¹ "human hungers,"² or tendencies which must be considered in an attempt to analyze the factors that control individual and market demands.³ No attempt is made at this point to treat this important subject exhaustively, as such treatment lies in the field of the psychologist. We can examine briefly, however, some of the more important wants and note their relationship to the problems of marketing. The reader should keep in mind during this discussion the fact that these inherent tendencies are only parts of the whole of human nature. The division is made for the purpose of discussion. These tendencies in practice are so interwoven as to defy isolation. Demand, in fact, is conditioned by the total personality of the individual.

The most primitive of human motives, hungers, or wants is a *desire for life*. All people want to live, to be healthy, happy, free from pain, disease, and deformity. They want to shun hardships and serious dangers, although some seek the thrills of adventure. This longing for life accounts for the demand for specific kinds of food, clothing, and shelter and for the great interest in many sports, forms of recreation, medicines, and safety devices. The emotion *fear* arises largely from a feeling on the part of the individual that he may not be able to satisfy his "hungers." Many articles are sold through an appeal based upon

¹ STRONG, E. K., *Psychology of Advertising and Selling*, Chaps. IX, X.

² NYSTROM, P. H., *Economics of Fashion*, pp. 56 ff.

³ Professor Laird, in *What Makes People Buy*, discusses four fundamentals of customer motivation, viz., unconscious desires for adequacy, for romance, to live forever, and for masculinity.

arousing fear and then holding out the article or service as a remedy. The sellers of insurance, drugs, nostrums, tire chains, and fire extinguishers, among others, have resorted to this appeal.

The *sex desire* is one of the most pervasive of the basic motives. It explains the universal practice of individuals seeking the society of members of the opposite sex and of carrying on the various forms of byplay which are associated with sexual activity.¹ The securing and maintaining of this association become a major objective at times and greatly influence the demand for clothing, cosmetics, perfumes, and other toilet articles, as well as some of the accomplishments, such as dancing, music, and sports.

The sex motive is directly related to the family life and the love of children. This powerful inherent human trait accounts for the purchase of many articles bought as gifts, toys, home furnishings, and articles of dress. Expenditures for certain forms of service, such as for educational opportunities, entertainment, and travel, may be traced, at times, to the desire to satisfy the sex hunger.

Gregariousness, or the desire for comradeship and friendship, is another common human trait. There are few people indeed who do not want to be with others. They seek out people who are congenial, and they in turn try to be agreeable to others. A person likes to think of himself as belonging to a society, a community, or a country. One of the worst forms of punishment is to be a man without a country. This desire "to belong" causes people to try to be like their friends and associates in ways of thinking, manner of speaking, and forms of dressing. To be different in any of these is to invite criticism, suspicion, or mockery. The desire to secure and maintain comradeship and friendship leads to a tendency toward uniformity, imitation, cooperation, and, in some instances, to docility.

Self-assertion is the attempt of the individual to impress his personality upon some one in particular or the group in general. It is the expression of the ego. People desire recognition of their strength, physical beauty, artistic attainments, and mental astuteness. They "show off" or display their attainments, possessions, and acquaintances with the expectation of securing the approbation of others. Expressions of pride, envy, ambition, rivalry, conquest, and greed are some of the outstanding characteristic evidences of the desire for self-assertion. The experience and imagination of the reader will readily supply instances illustrating how this fundamental trait influences at least in part our great interest in athletics. The use of stadiums, athletic equipment, transportation facilities, and other forms of services creates a market amounting to

¹ TEAD, ORDWAY, *Human Nature and Management*, p. 26.

millions of dollars annually. Conspicuous consumption and various forms of emulation are other familiar expressions of self-assertion.

Another trait that is important in explaining man's behavior is *curiosity*. Men, women, and children seem to have the tendency well developed. We want to see, to feel, to smell, to examine. We want to know the reason why—"what makes the wheels go 'round." People like to experiment, to explore, and to attempt new projects, and to "see what they can see." This universal desire is the propulsive force back of much of the vogue for traveling and touring. It makes possible the breaking away from old custom and the establishment of new fashions and new habits. Much of our social and industrial progress has been due to the force of curiosity. The learning process is dependent to a considerable extent upon this trait.

The desire for *ownership* is apparently a characteristic human trait. The presence of this desire appears in the child at an early age. He likes to collect articles and call them *mine*. If an attempt is made to take them from him he will cry and even fight for them. Adults desire to *own* their homes, clothes, cars, and so on. The desire to collect antiques, curios, and postage stamps is probably a manifestation of the ownership hunger. People want to own that which will meet their needs. The ownership desire, to a certain extent, is pervasive. Thus a woman may want to *own* an expensive fur coat or automobile in order to impress some friend or rival with her importance. In this instance she is also satisfying her hunger for *self-assertion*.

Psychologists have catalogued a large number of inherent traits or wants a knowledge of which is valuable in explaining the whole range of human behavior. The six classifications listed above have been made broad enough to include the more important motives for buying. These basic motives, which vary in intensity in different individuals and even in the same person at different times, comprise the foundation of all buying. These desires are so strong that they push people on to make great effort and even sacrifices to satisfy them. The buyer, perhaps, is not usually conscious of these basic desires as such. He wants the latest model of a certain make of automobile. The chances are he is not conscious of the driving motive at the base of this desire. He probably thinks he wants the car for some utilitarian reason, when in reality the motive force is the satisfaction he expects to reap from "impressing" his friends and the "pride of ownership" of such a high-priced, smooth-running, beautifully finished machine. A knowledge of these basic motives that condition human behavior and of their direct relationship to the demand for specific articles of merchandise and of services is essential to effective marketing administration. People educate themselves, work, and engage in various production activities in order to secure

money with which to purchase goods and services to satisfy their wants. The race, the nation, or the individual that is satisfied does not desire much and, consequently, does not produce much.

The Elements of Buying Practices.—Buying practices are influenced, as was suggested above, by such elements as sex, age, religion, occupation, social standing, marital status, and manner of living. This is due to the fact that the “hungers” may vary in intensity according to sex, age, race, and so on. In so far as this is true, it should be the major objective of the sellers, whether they be farmers, manufacturers, merchants, physicians, or other producers of services, to determine just how much the sale of their products or services depends upon any given element.

Buying Practices as Influenced by Sex and Family Life.—Attention has recently been called to the differences in buying motives of men and women. The status of women throughout the civilized world, and especially in Western Europe and North America, has changed greatly since 1918. Women control a large proportion of the wealth and income of the United States and they control a very much larger proportion of the expenditures for consumers’ goods.¹ It is estimated that women buy 41 per cent of the automobiles, 78 per cent of the drugs, 80 per cent of the electrical supplies, and 98 per cent of the household furnishings. They spend 85 per cent of the nation’s payroll and plan the expenditure of 10 per cent more.² A more recent study indicates that the housewife exercises greater influence than other members of the family, with regard to price paid and kind and brand of product bought, in the purchase of such grocery store products as cereals, canned goods, desserts, coffee, and toilet soap. There are many instances, however, in which the husband is an important influencing factor.

Women are usually more patient buyers than men; they are willing to spend more time in comparing values. They probably get more for their money because of this careful attitude. They are influenced, perhaps, more by what they think others will think of them than are men, and they also pay more attention to changes in fashions. Mrs. Frederick says that woman is predominantly emotional and is governed more by inherent desires than by logic.

¹ According to fairly reliable estimates, 65 per cent of all estates go entirely to women each year; in addition, insurance companies pay women \$800,000,000 annually. Forty per cent of the individual wealth of the United States is in the possession of women; more than half of the incomes above \$100,000 annually are reported by women. Women spend \$2,000,000,000 annually for beauty preparations, luxuries, and ultra-fashionable clothes which they cannot wear for any length of time. Prof. D. A. Laird.

² FREDERICK, C., *Selling Mrs. Consumer*, Chap. VI. These statements represent Mrs. Frederick’s opinion. The student will readily understand that there is much room for differences of opinion as to the distinctive psychological characteristics of women.

Women's characteristic attitude is *dislike*, while men's is *like*; women respond more quickly to appeals to their dislikes, while men respond readily to their preferences. Women are more receptive and open to suggestions than men. Women's attention is easy to get but hard to hold. Personal appeal is more effective with women. Men respond to action appeals more readily, while women respond to visual appeals.¹

According to Professor Laird, women have slower reaction time than men; consequently, they take more time to form a decision and to act.

- Women give more attention to personal appearances and are more concerned with what others think of them. They desire variety more than men; for example, 72 per cent of the fads are in women's dress and decorations, while only 10 per cent of the fads are in men's dress and decorations. Women in their buying are affected more readily than men by minor features. They bought, for example, 50 per cent more of a certain kind of hose which was pleasant scented than they did of the identical kind and grade which was unscented. Women are generally more considerate of the feelings of others and are more sensitive to what they consider ill treatment or lack of consideration from others. This fact explains their objection to the services of certain sales people.

The merchants of New England say that when men buy clothing the first thing they look for is quality in the cloth; second, the price; and third, the tailoring and general finish. Style probably comes first in the upper price ranges, then price, and quality last. In the lower price merchandise, price comes first, followed by style and quality.²

Table 7 indicates the relative influence of husband and of wife in determining the purchase of certain family articles.³ These results suggest that the buying habits of individuals may be influenced by sales promotional activities, since many of the products listed have been aggressively advertised.

Another study reports that in the purchase of the more durable and expensive products, such as automobiles, radios, rugs, electrical refrigerators and other electrical devices, the male influence is greater than the female when price is considered; the female influence is only slightly greater, according to this study, with reference to the kind of product.⁴ When brand is considered the male has slightly greater influence. The male member of the family is reported to influence the kind and brand of product as well as the price paid for cosmetics in one-fifth to one-fourth

¹ *Ibid.*, Chap. V.

² "The Retailer and the Consumer in New England," *U.S. Department of Commerce, Trade Information Bull.* 575.

³ ARNOLD, PAULINE, "Who Buys What," *Advertising and Selling*, pp. 27 ff., July 19, 1934.

⁴ HEPNER, H. W., Syracuse University, "Relative Influence of Men and Women in the Purchase of 12 Commodities," *Redbook Mag.*, 1933.

of the families studied. His influence is greater with reference to the purchase of toothpaste. Apparently, then, both members of the partnership must be considered when sales are planned by the manufacturer or merchant.

TABLE 7.—RELATIVE INFLUENCE OF HUSBAND AND WIFE IN THE PURCHASE OF CERTAIN PRODUCTS¹
(In percentage)

Product	Husband	Wife	Both
Electric fans.....	55	24	21
Electric clocks.....	50	36½	13½
Electric toasters.....	25	68½	6½
Washing machines.....	18	43	39
Automobiles.....	58	6	36
Gasoline, motor oil, tires.....	90		
Mattresses.....	8	57	35
Rugs.....	8	47	45
Hair tonic.....	51		
Bath soap.....	10	90	
Tooth brush.....	25	75	
Dentifrice.....	33½	66½	
Breakfast foods.....	14	86	
Coffee.....	33½	66½	

¹ ARNOLD, PAULINE, *op. cit.*

The Influence of Intelligence.—The nature of the relationship existing between willingness to buy and intelligence is not known. There is, generally speaking, a positive correlation between intelligence and earning power. It is a well-known fact, however, that there are a large number of people with high purchasing power and low intelligence. This situation tends to encourage, on the part of some sellers, high-pressure selling and unethical marketing practices. It is equally clear that a high degree of general or specialized intelligence does not always promote intelligent buying. We believe it is safe to say, nevertheless, that there is a greater probability of intelligent buying when the consumer possesses average and above average general intelligence. Table 8 gives an estimate of the distribution of population, on the basis of intelligence, for the year 1929.

The Influence of Age.—The demand for merchandise and services is conditioned to a considerable extent by the age distribution of the people constituting the market. The needs of children generate a demand for toys, clothing, educational supplies and equipment, certain forms of amusement, and other merchandise and services particularly designed for the convenience, amusement, and comfort of the younger generation. Each major age group, whether men or women, has certain desires and needs that are characteristic of its particular age. Thus to use women

as an illustration, according to Mrs. Frederick,¹ the young woman is interested in personal adornment, pleasure, style. She wants excitement and is vain. The more mature woman, i.e., middle aged, is interested in health, sanitation, hygiene, economy, labor saving, and efficiency, yet the appeals of youth are still strong. After thirty-five, women think more of luxuries, comforts, travel, health; they want more pretentious homes, cars, and clothes so as to impress others. Conservatism and habit are important attributes.

TABLE 8.—DISTRIBUTION OF INTELLIGENCE IN THE UNITED STATES¹

• Number in each class	Descriptive classification	I.Q. rating
250,000	"Near genius" or genius	140 up
6,750,000	Very superior	120 to 140
13,000,000	Superior	110 to 120
30,000,000	High average	100 to 110
30,000,000	Low average	90 to 100
13,000,000	Dull	80 to 90
6,000,000	Border line	70 to 80
750,000	Morons	50 to 70
250,000	Imbeciles and idiots	50 down

¹ URBROCK, R. S., in *Industrial Medicine*, February, 1934.

Some fundamental changes are taking place in the composition of our population. The Bureau of the Census estimates that the population of the country will reach its peak before 1950 unless the birth rate rises or immigration increases.² The present birth rate is not believed to be sufficient to maintain the population at a stationary figure, so an actual decline in population is a possibility in the not far distant future. Prior to the World War the population increased at an average of approximately 1,800,000 people a year; by 1934 the annual increase was approximately 800,000. The decline in the rate of population increase is producing some important shifts in age distribution. Thus there are fewer children and more old people. The following table gives the census figures for four census years:

¹ *Op. cit.*, Chap. III.

² According to estimates by Thompson and Whelpton, the population of the United States will be 131,865,000 in 1940—76,039,000 classed as urban; in 1950 the population will be 138,442,000—80,862,000 classed as urban; in 1960 the estimated population will be 141,485,000—82,436,000 classed as urban. During this period the rural farm population will steadily decrease, while the rural non-farm population will increase. These estimates are based on the assumption that internal migration similar to that of 1920-1929 will continue.

TABLE 9.—AGE DISTRIBUTION OF POPULATION OF UNITED STATES FOR INDICATED YEARS¹

Age	1900	1910	1920	1930	1940
Under 15...	34.4	32.1	31.8	29.4	
15 to 34....	35.5	36.2	33.9	33.7	
35 to 54.....	20.5	21.8	23.4	24.6	
55 and over.	9.4	9.7	10.9	12.3	
Unknown...	0.2	0.2			
Total.	100.0	100.0	100.0	100.0	

¹ *Statistical Abstract*, p. 39, 1933.

The percentage of children under fifteen years fell from 34.4 per cent of the total population in 1900 to 29.4 per cent in 1930.¹ The proportion of the population between the ages of fifteen and thirty-four fell from 36.2 per cent in 1910 to 33.7 per cent in 1930; on the other hand, the proportion between thirty-five and fifty-four increased from 20.5 per cent in 1900 to 24.6 per cent in 1930, while those over fifty-five increased from 9.7 per cent in 1900 to 12.3 per cent in 1930.² The percentage of the population gainfully employed has remained about the same, but there has been an important change in the composition of the employee group. More women are being employed, and fewer children and older persons. Thus the percentage of children, ten to fifteen years old, employed in 1900 was 6 per cent of all gainfully employed; in 1930 the figure was only 1.4 per cent. There are now many more children and young people in schools of various kinds than there were fifteen years ago.³

These changes in population characteristics will affect the demand for goods and services in a very pronounced way. There will be less demand for children's goods and more for merchandise and services used by adults. The importance of the demand for toys, for example, is indicated by the following census figures. According to the preliminary estimates of the 1934 Census of Manufacturers, 7,976,529 dolls with an f.o.b. factory value of \$4,534,507 were produced in 1933; the value of metal toys, other than mechanical, was almost \$8,000,000; mechanical toys propelled by springs or by electricity had a value of almost \$4,000,000; baby carriages, go-carts, strollers, and sulkies were worth more than

¹ It is interesting to note that the percentages of boys and girls fourteen years old and under were equal in 1930.

² There were approximately 10,385,000 people, 8.5 per cent of the total population, sixty years old and over in 1930; approximately 18,000,000, or 15 per cent, were between forty-five and sixty years of age. There were, in 1930, 102.5 males to every 100 females in the United States.

³ There are approximately 6,000,000 children attending high schools in the United States.

\$3,000,000; approximately 1,030,450 velocipedes and tricycles had a value of \$2,655,613. Almost 2,000,000 wagons for children were produced. The total value of such products was in excess of \$48,000,000 in 1933, approximately \$70,333,000 in 1931, and almost reached \$104,000,000 in the prosperous year of 1929. Per capita income will probably increase, as will also real wages and the standard of living. There will, therefore, probably be less relative demand for staple goods and more for semi-luxury and luxury goods. There will be a greater demand for variety and better quality. Sales volume will depend more on larger per capita purchases through repeat sales and the introduction of new products than on securing new customers from immigration and the rising new generation.

The Influence of Religion and Race.—Religion influences demand in a number of ways. In addition to the special demands that arise for materials, equipment, and services directly connected with the various forms of worship, the observance of holy days, feast days, and the like greatly affects the demand for goods and services. A brief statement of the effect of the Jewish Kosher demand upon the marketing of live stock serves as an illustration of the effect of religion upon demand.¹ Of course, no pork is bought by Orthodox Jews. Cattle, sheep, and fowls which are eaten have to be slaughtered according to certain prescribed methods by especially trained representatives of the Jewish faith.

The dietary habits of the Jews are most significantly influenced by their religious feasts and fasts, and in consequence the beef trade feels the effect of these religious occasions and must take them into careful account. All of the religious events are fixed by the Jewish calendar, and are identical throughout the world among Orthodox Jews. Therefore, every live-stock market and the entire beef trade are affected at the same time by the demands of the Kosher trade.

A period of twelve days, including the last few days of September and the first few days of October, are Jewish high holidays for the New Year's celebration. This event, being a feast period, creates a great demand for Kosher beef and necessitates the shipment of large numbers of live stock east to meet the Kosher demand. The schedule of shipment has to be carefully timed so that the live stock will arrive at the right time. The big buying days for Kosher beef are Monday and Friday. Only the fore-quarter of the beef is used in the Kosher trade.

The extent of the Kosher demand in the United States is surprising; 25 per cent of all steers sold under federal inspection in the United States are Koshered. It takes, in round numbers, a half million steers annually to supply the Kosher trade of Greater New York.

¹ The material for this discussion is taken from "What 'Kosher' Means to the Meat Industry," Armour Live-stock Bureau, *Monthly Letter to Animal Husbandmen*, Vol. X, No. 3, June, 1929.

The Effect of Occupation on Demand.—It is not necessary to go into an extended discussion in pointing out the effect of occupation on demand. It is obvious that workers in the various industries must be supplied with suitable clothing, food, shelter, tools, machines, materials, and supplies. As soon as agriculture, fishing, mining, lumbering, manufacturing, and plumbing are mentioned, one instantly thinks of certain special demands of the participants in these industries. The professions—dentistry, law, engineering, medicine, teaching, the ministry, accounting, advertising, and business administration—likewise call to mind other special needs. There is evidence which indicates that the type of occupation may have a definite bearing upon the *willingness* of the consumer to buy; e.g., it is said that miners and railroad workers are “free spenders.” When they are working they live well.

Effect of the Social and Marital Status on Demand.—The social standing of an individual or a family quite frequently plays an important part in guiding demand. Thus a woman may be elected president of some club and, as a result, feel that she must dress, furnish her home, and otherwise act accordingly. The physician, the lawyer, and the local banker in the county seat are regarded often as people of considerable consequence. Their social status is such that people “look up” to them. They in turn usually feel that they must act the part. Their homes must be above the ordinary; their dress, manners, and accomplishments should fit into this picture if they are to maintain their prestige in the community.

The marital status causes some changes in an individual's wants. Married people usually assume a more serious and responsible attitude. The attention is centered more on the home, its equipment, and the care and happiness of the family rather than as much as formerly upon personal attractiveness, pleasure, and personal convenience. Economy, perhaps from necessity, is practiced more assiduously. It is estimated that there are approximately 1,100,000 marriages yearly, 2,500,000 births, and 1,500,000 deaths.¹ The marital state brings with it great responsibilities and is the source of many and varied needs. How well these needs are met depends upon the income of the family, its standard of life, and the general intelligence and common sense of the individuals in the group.

The Changing Manner of Living.—As time goes on, there is a constant change in our manner of living which causes changes in our buying habits and practices. It is not necessary to list all of these manifold changes and their causes. If we select a few of the more important ones and briefly point out their relationship to demand, the reader will, no doubt, be able to supply many more illustrations from his own experience and observation.

¹ Approximately 2,950,000 children were born in 1921, but only 2,260,000 in 1933.

The Effect of Inventions and Discoveries.—The last thirty years have brought about a revolution in our manner of living, due to improvements and changes in the character of our industries, housing, transportation, forms of amusement, and the like. There has been a decided increase, for instance, in the number of people living in cities and in apartment houses. Living quarters are smaller, so people buy less heavy furniture and smaller quantities of food products, but at more frequent intervals. Women have found more employment outside the home and, consequently, need more street clothing; they do less cooking and therefore patronize more the restaurant and the delicatessen store. There is now a much greater demand for ready-to-serve and package foods; outdoor lunches are more popular because of the great vogue for touring. As new industries developed, the volume of sales grew, changes in occupation resulted, and life in general was changed for millions of people.

The development of the internal-combustion engine made the automobile possible. Its widespread use created a tremendous demand for gasoline which up to that time was a waste product manufactured incidentally with the production of kerosene. The development of automobiles, trucks, and tractors had an adverse effect upon the use of horses, mules, clipping machines, harness, carriages, and bicycles and changed many of the living habits of a nation. It is claimed by the textile industries that the automobile has influenced men to buy less clothing; they buy less frequently, and there is a tendency to buy cheaper clothing. The automobile is credited with popularizing sport wear, so that men can wear sport clothes into a hotel or golf club and still be dressed in good form.¹ The closed car and centrally heated homes reduced the demand for umbrellas, heavy underwear, overshoes, and many other articles of clothing. The development of the petroleum and electrical industries reduced the whale-oil and tallow-candle industries to relative unimportance. Electricity displaced gas for street lighting and kerosene for home lighting; before this time kerosene had displaced the candle, and gas had displaced wood and coal for cooking in cities. The development of the radio greatly curtailed the sale of phonographs and other musical instruments. When the alternating-current sets were put upon the market, battery sets became obsolete in the cities. One can readily recognize the effects of the telephone, washing machine, vacuum cleaner, mechanical refrigerator,² and the motion picture upon the demand for certain products which were formerly widely used. Much criticism has been directed at the ruthlessness of the competition

¹ "The Retailer and the Consumer," *The New England Survey*, p. 24.

² The annual sales of electric refrigerators increased from slightly more than 500,000 in 1929 to more than 1,300,000 in 1934, and this number was increased during 1935, owing partly to a substantial decrease in price.

arising from inventions. Nothing can or should save an industry whose products are no longer wanted by the public. Price fixing, subsidies, restriction of production, artificial and protective measures may prolong their existence at an unreasonable cost to society, but eventually they must be eliminated.

The extensive use of one article may create a demand for others. Thus the use of the automobile created a demand for steel, aluminum, rubber, glass, oil, and a large number of accessories. The sale of the automobile itself has doubtless been stimulated by the development of such products as the self-starter, four-wheel brakes, and balloon tires. The demand for poultry products is affected by the supply of certain other food products; for example, one explanation for the high per capita consumption of eggs in Canada when compared with that of the United States is that fresh fruits and vegetables are not so plentiful and cheap in Canada; consequently, more poultry and eggs are consumed. The increase in per capita consumption of poultry products in the United States during recent years is explained by the changing living conditions in the towns and cities. "The hen house has been replaced by the garage. The automobile and radio are receiving much of the attention formerly devoted to the chicken flock and the vegetable garden."

The Influence of Custom.—Local tradition, habit, custom, and mental inertia tend to prevent changes from being made. It is said that green automobiles can not be sold in India because green is regarded as a color of ill omen; in Japan, maroon is the color of the Imperial household and would be barred; yellow, in China, is the color of mourning, so a yellow car would be unpopular. Some people in certain sections of the United States believe, without good reason, that white eggs are superior to brown, while the reverse is believed by some persons in other sections. Manufacturers of certain products have found it necessary to continue to package the identical product under several different labels so as to meet the wishes of their customers in different sections of the country. Some farmers prefer left-handed plows; others want only right-handed ones. In the United States the steering wheel of the automobile is on the left side of the car; in Europe it is placed on the right side.

Why the Increased Emphasis upon the Style Element?—While people have always been subject to style changes, fashion, since 1923, has been much more prominent in causing changes in demand. The automobile, motion picture, radio, and women's magazines have made it possible to disseminate quickly, throughout the country, knowledge concerning changes in style. Manufacturers, because of excess production capacity and keen competition, have used great ingenuity in making the best of the opportunities offered for promoting rapid style change, thus increasing sales. The greatly improved facilities for rapid transportation have

made hand-to-mouth buying possible, which in turn has aided the movement. Consumers are now looking for *effects* in color, design, and style; they take quality more or less for granted. The modern emphasis upon style has had unexpected results upon demand and sales. One has only to think of the effect of bobbed hair upon the hairdressing, hairpin, and millinery industries; of short skirts upon the shoe and the hosiery and other textile industries.

The fashion movement has been greatly accelerated by mass production of garments at popular prices, and firms engaged in the style business are just as likely to lose from being ahead of the fashion as those who consistently lag in the same movement. It is believed that by far the largest mark-downs in the marketing of women's coats and suits were caused by style obsolescence rather than by special concessions, group buying, or extra margins. Frequency of mark-downs increased with large-scale production of style garments, and conditions are such that mark-downs have to be taken oftener and earlier than when style was a less important factor.¹

Distinction between Style and Fashion.—The term *style* applies to all creations and designs whether accepted by the public or not, while the term *fashion* applies only to those styles which are accepted by the public.²

There are three forces that influence fashion, according to Professor Nystrom,³ *viz.*, dominating events, such as the World War; dominating ideals, such as the current youth movement; and dominating groups, such as the present-day people of wealth, who have acquired the "subtle art of artistic spending." Professor Cherington⁴ believes that fashions are dependent on fundamental social changes. Four recent events have had marked influences, *viz.*, the World War and its aftermath, the advances in science affecting the habits of daily life, the era of great prosperity during the 1920's, and the recent years of depression and economy.

Styles that become fashionable seem to follow certain rules. Thus they should give the impression that the possessor does not have to work for a living, *e.g.*, creases in men's trousers; they must appear expensive; and they should have a semblance of utility, *e.g.*, ordinary "sport" dresses that are not really durable enough for sport.

The fashion at present demands the slim figure for women. As a result, the sale of starchy and sweet foods and the consumption of meat

¹ KEDSIBRSKI, S. L., *Domestic Commerce Ser.* 91, 1934.*

² NYSTROM, P. H., American Management Association, *General Management Ser.* 97, p. 20.

³ *Economics of Fashion*, Chap. IV.

⁴ CHERINGTON, P. T., *The Report on the Commercial Problems of the Woolen and Worsted Industries*, Chap. III.

are somewhat reduced. To meet this desire for thinness, one manufacturer used these appeals: "_____ is a hearty food but not fattening" and "_____ is a body builder but not fattening." Fashion causes men to shave daily and wear straw hats in summer, and it causes people to replace their automobiles, furniture, radios, and clothing long before these articles are worn out.

The student should not lose sight of the fact that changes in fashion frequently necessitate corresponding changes in production. Some producers may find it impossible to produce the goods demanded. The change in demand in the textile field that called for wider fabrics and lighter weights and the shifting of preference from soft to more tailored fabrics necessitated important changes in mill practice.

Motives Governing the Buying of Non-consumer Goods.—Industrial and institutional buyers make their purchases to meet certain objective needs and standards. The merchant, when buying his equipment, is governed by the same motives that guide the industrial purchaser. When he buys his merchandise for resale, however, he tries to interpret the needs, wants, and desires of his prospective customers—the ultimate consumers. The merchant buys for the purpose of resale at a profit. This he expects to secure from a rapid turnover and a satisfactory margin on each sale. He knows, however, that he must buy merchandise that will satisfy the desires of his customers if he is to succeed. The motives that govern the purchase of industrial goods are somewhat different. The typical industrial buyer, in contrast to the typical consumer, is an expert in judging quality and prices; he is also a skillful bargainer and has at his command a large fund of technical and market information. He is not, as is the case with the consumer, guided by personal whims and fancies. He is held accountable to his company for satisfactory results.

The demand for industrial goods has a much more definite limit than that for consumer goods. Since the purchases are made chiefly on a utilitarian basis there is small possibility of expanding sales through any form of emotional appeal. A large proportion of industrial goods is durable in character; consequently, replacement purchases can be delayed for a considerable time. This fact causes demand to fall drastically during periods of depression.

The chief factors that determined the purchase of a particular industrial product in 324 cases reported by Eldridge Haynes¹ are (1) performance, which was the chief factor in 46 per cent of the transactions. Standardization was the leading requisite within the performance classification, and past experience was the next in order of importance. (2) Price was the determining factor in 26 per cent of the cases. (3) Con-

¹ *Class and Industrial Marketing*, pp. 68 ff., January, 1928.

struction of the product was the most important factor in 25 per cent of the cases. Quality was the first requisite, while technical features were second. Other factors were (4) confidence in the company, based on the recommendation of others or on the buyer's experience, and (5) reciprocity. There are, with certain products, other motives that influence industrial buying at times. Thus an accessory or piece of equipment may be bought to be attached to the article sold by the manufacturer because it is well known and will aid the sale of the major article. A machine may be bought because it will reduce the costs of production; it may, for instance, have a larger capacity or use less power, be more durable, more flexible in use, more dependable in operation, or easier to install or repair. Industrial goods may be bought because they facilitate the health, comfort, and safety of employees or because of some special service feature stressed by the seller, such as punctuality and promptness in delivery, time-payment privileges, special installation service, and a reliable source for future needs.

Mr. Frederick classifies the demand for industrial goods under three headings and calls each a market; thus (1) *horizontal market*, in which is found a demand for standard equipment and supplies used by industry generally, *i.e.*, office equipment, maintenance, and operating supplies and equipment; (2) *vertical industry market*, in which is found a demand for highly specialized supplies and equipment used only by the particular industry, *i.e.*, ovens for bakeries; and (3) *vertical product market*, in which there is a demand for specialized equipment and supplies used only in plants making specific and highly specialized products, *i.e.*, brasses for electric light bulbs.¹

The Time Element in Demand.—The knowledge of purchasing power and buying motives needs to be supplemented by a knowledge of *when* buying takes place. The time when people buy may be determined by a study of a number of conditions and events. The time of day when the greatest bulk of purchases is made seems to vary according to the size of the city. In cities of 2,500 to 3,000, approximately 32 per cent of the shopping is done before 11 a.m., and 60 per cent after 3 p.m., with business dull around noontime. This is due to the living habits of cities of this size. A small percentage of the women work outside the home, and a large proportion of the husbands come home for lunch; consequently, the women do their shopping either in the early morning or in the late afternoon. The situation is different in cities of 500,000. Here it is estimated that only 4 per cent of the sales are made before eleven o'clock, 71 per cent between 11 a.m. and 3 p.m., with 25 per cent after 3 p.m. It appears that the larger the city the greater the proportion of buying that is done during midday. More women work outside the home

¹ FREDERICK, J. H., *Industrial Marketing*, p. 8.

in the larger cities, fewer men go home for lunch, and there is a tendency for women who do not work outside the home to do their shopping during the midday; and a large number of women workers utilize their lunch hour for shopping.

There is a definite variation in the seasonal volume of buying. The greatest volume of department store buying in the United States, for example, takes place in the autumn, culminating in a major peak just prior to Christmas. There is a much smaller peak in April and May. The smallest volumes of sales are made in January and February and in July and August. When the seasonal trend is eliminated the volume of sales tends to rise and fall with changes in business conditions. Part of this rise and fall, however, is caused by changes in prices rather than in physical volume of business transacted. Indexes of marketing activity indicate that there are definite seasonal variations in mail-order house sales, wholesale trade, car loadings, merchandise exports, and construction contracts. These transactions reflect the time element of demand. The fluctuations in demand appear to follow about the same course as department stores to the extent of having two peaks and two valleys. The peaks and valleys in wholesale trade seem to anticipate the retail peaks and valleys, while construction demand shows the adverse effect of the winter months.

The volume of sales varies also according to the days of the week. Some retail stores transact almost half their weekly volume on Saturday. Since people now buy in smaller quantities, more frequent buying—so-called hand-to-mouth buying—is necessary. The happening of certain events, such as weddings, funerals, births, marriages, commencements, inaugurations, fairs, expositions, picnics, and holidays, introduces the time element into demand. All such occasions must be anticipated by the merchant and the manufacturer so that the required merchandise will be ready for the consumer when he wants it.

The Place Element in Demand.¹—The increased use of the automobile has changed people's habits with reference to the places where they buy. There has been a distinct trend from the crossroad and village stores to the county seat and larger cities by a large portion of the rural population. The farmer's family is not content to do all its shopping from the mail-order house catalogue and small-town store. The rural people want new styles, good quality, satisfactory service, and greater variety of choice at a reasonable price; consequently, they take advantage of the good roads and go 5 to 60 miles to do their shopping and to hear the latest talkies.

¹ For a fuller discussion of the importance of location, cf. J. F. Pyle, "The Determination of Location Standards for Retail Concerns," *Harvard Business Review*, Vol. IV, No. 3, pp. 303 ff., April, 1926, and "The Determination of Standards of Layout for Retail Concerns," *University Jour. of Business*, pp. 328-347, October, 1926.

The inconveniences of parking have caused large numbers of the city people to shun the down-town shopping district except on rare occasions. They are turning to the outlying shopping districts. Many of the large down-town stores have established branches in these outlying districts, the suburbs, and smaller cities so as to meet the changed conditions. The old-type specialized store, as well as the old country general store, has ceased to exist. The modern drug store maintains a soda fountain and lunch booths and carries tobacco products, candies, toys, electrical goods, and some articles of clothing. Grocery and hardware stores, filling stations, clothing, hat, and shoe stores have added to their lines so as to meet the desire of the consumer to be able to supply certain of his supplementary wants at the same place.

The portion of the consumer's dollar spent in thirteen forms of retail outlets is indicated in Table 10.

TABLE 10.—WHERE THE CONSUMER SPENT HIS RETAIL DOLLAR IN 1934¹
(Total retail sales \$28,548,000,000)

Place	Cents
Retailers of food.....	31.4
Food stores.....	25.5
Restaurants and eating places.....	5.9
Automotive retailers.....	18.9
Department stores, dry goods, and other general merchandise stores.....	11.7
Apparel stores.....	7.9
Farmers' supply and country general stores.....	6.5
Lumber, building, and hardware stores.....	5.4
Drug stores.....	4.1
Furniture and household stores.....	4.0
Variety stores.....	2.6
Mail-order houses, catalogue sales only.....	1.0
All other stores.....	6.5

¹ MILLER, N. A., *Domestic Commerce*, Feb. 20, 1935. The estimated volume of retail sales for 1934 was 14 per cent greater than the volume reported for 1933 by the *Census of American Business*.

The sales of retail stores do not reflect all the purchases of the consumer. While the major portion of his demand is satisfied at some independent or chain store, many of his expenditures are not reflected in the retail census figures. Some of his other expenditures are for electric, gas, water, telephone, educational, medical, and dental services; he may contribute also to church, lodge, and charity; he pays an appreciable amount of money as taxes and for hotel, theater, barber, beauty parlor, and other services for his own personal benefit; and he perhaps makes some investments.

Geographic Aspects of Demand.—Buying habits and practices are influenced by geographical location. Local industry, as was indicated above, governs the demand for many products. Habits and customs

peculiar to the district usually have their base fixed on some racial or industrial characteristic. Climatic conditions in a given locality frequently determine the time of purchase as well as the kind and amount. It is clear that the nature of local industry, racial factors, and climatic conditions produce regional differences in per capita consumption of goods and services. The following table shows how the purchase of three items of electrical equipment varied among eight cities:

TABLE 11.—PURCHASES OF ELECTRICAL APPLIANCES¹

City	Percentage of families purchasing ¹		
	Vacuum cleaners	Washing machines	Electric refrigerators
A.....	37	2	19
B.....	67	66	19
C.....	56	16	3
D.....	61	53	15
E.....	37	34	7
F.....	46	31	11
G.....	61	40	20
H.....	56	61	13

¹ Published by A.N.P.A., 1934. Data collected by the R. L. Polk Co.

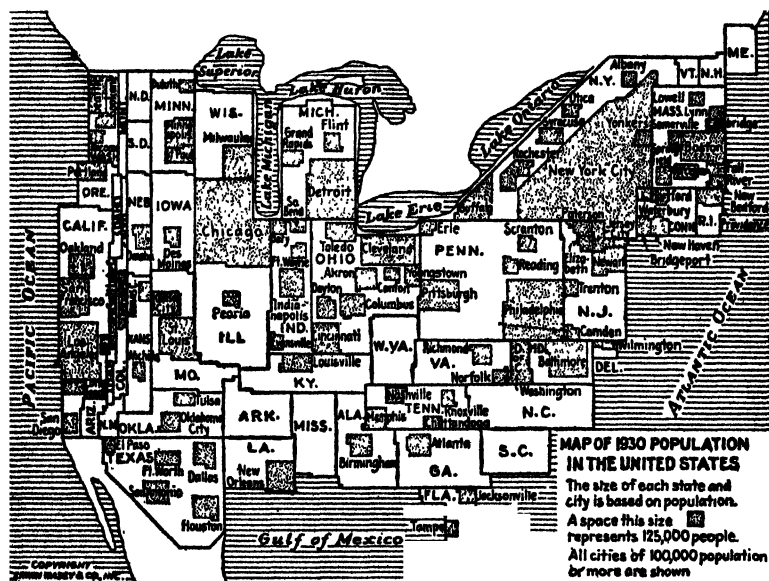
We should expect to find products that have been on the market for a long time, such as vacuum cleaners and washing machines, to have a more concentrated use than the more recently introduced products, such as electric refrigerators;¹ yet in City A only 2 per cent of the families have washing machines, while 19 per cent have electric refrigerators and 37 per cent own vacuum cleaners.

In City C only 3 per cent of the families have electric refrigerators, but 16 per cent have washing machines and 56 per cent have vacuum cleaners. Information is not available with which to explain the wide variations found among these cities. The geographical factors, no doubt, play an important part in producing these differences.²

¹ The electric light bulb and the non-automatic electric iron have the widest distribution; approximately 2 homes out of 3 in the United States are wired for electricity. For the country as a whole, approximately 9 out of 30 homes have vacuum cleaners; 6 out of 30 have washing machines; while only 3 out of 30 have electric refrigerators. Only 12 out of 30 homes have telephones. In 1933, approximately 48½ per cent of the wired homes had vacuum cleaners, 44 per cent had electric washing machines, 24½ per cent had electric refrigerators, and only 3¾ per cent had oil burners.

² The differences in the cost of electrical power in the various localities would affect the ownership and use of electrical appliances.

The volume of sales of many products bears a close relation to the number of people in a given area. This is especially true with reference to staple goods used as food and clothing.¹ One is likely to be misled, when looking at a map of the United States, concerning the importance of different sections of the country as potential markets. Some states, for instance, are big when measured on a square-mile basis but are relatively unimportant when measured on a population basis—whether as total population, as number of people per square mile, or as a percentage of the total population of the United States.



MAP 1.—Relative importance of each state on basis of population. (Reproduced by permission of Erwin Wasey & Co., Inc.)

The map above, constructed by one of the leading advertising agencies on data furnished by the 1930 Census of the United States, suggests the size of general demand as reflected by population figures. A comparison of the states of New Jersey, Massachusetts, and Connecticut with Nevada, Wyoming, and Montana, as depicted on the map, emphasizes the importance of determining the degree of correlation between territorial size and population size.

¹ The sales of some universally used goods having an inelastic demand, such as matches, table salt, and, to only a somewhat less extent, tobacco and gasoline, are in direct relationship to the number of people or the number of automobiles in the case of gasoline. The sales of the majority of products are affected by so many factors that a simple statement of the number of people is not sufficient to give an accurate rating as to buying potentialities.

The density of population of a state is indicated, to some extent, by stating its percentage of urban population. The percentage of urban population of the United States in 1910 was 45.8 per cent; by 1930 the figure had risen to 56.2 per cent. The District of Columbia is listed by the census as 100 per cent urban, Rhode Island 92.4 per cent, and Massachusetts 90.2 per cent. North Dakota, on the other hand, has only 16.6 per cent urban population, Mississippi 16.7 per cent, and South Dakota 18.9 per cent. Nevada, for example, has only 0.1 per cent of the total population of the United States.

Table 12 indicates the variation in per capita retail sales for the United States and through ten specified kinds of retail outlets and all other stores, in the nine geographic regions of the United States. The Pacific group ranks highest in four outlets for both census years and highest in two others during 1929. This region ranked first in the total column. The New England and South Atlantic divisions show relative improvements in 1933 over 1929, while the other divisions were more unfavorably affected. The variation in per capita purchases through similar kinds of stores in different geographical divisions is striking. The East South Central ranks high in per capita sales through country general stores. This section, however, spends much less per capita in food stores, eating places, filling stations, furniture and household and radio stores, lumber and building materials, hardware stores, and drug stores than any other geographical division. The climatic conditions of the section help to explain part of the low per capita purchases. The low purchasing power and standard of living of a large part of the population probably complete the explanation.¹

Map 2 indicates the geographic distribution of some important indicators of purchasing power. The number and the percentage of the United States total is shown by the nine geographic divisions, for (1) population, (2) retail sales, (3) sales of service establishments, (4) wholesale sales, (5) value of manufactured products, and (6) the number of individual income-tax returns. The United States totals for each classification are given in a box in the lower right-hand corner of the map. This map shows at a glance where the major portion of our retail, wholesale, and service sales are made; where the largest number of income-tax payers live; and where the major industrial districts are located. The student can determine significant relationships existing among these important factors.

¹ The 1933 per capita consumption of milk and cream (consumed as such) by sections of the country was North Atlantic, 42.9 gallons; South Atlantic, 28.7; North Central, 40.6; South Central, 29.7; Western, 40.1. *Some Facts about Evaporated Milk and Other Dairy Products*, Evaporated Milk Association, revised January, 1935.

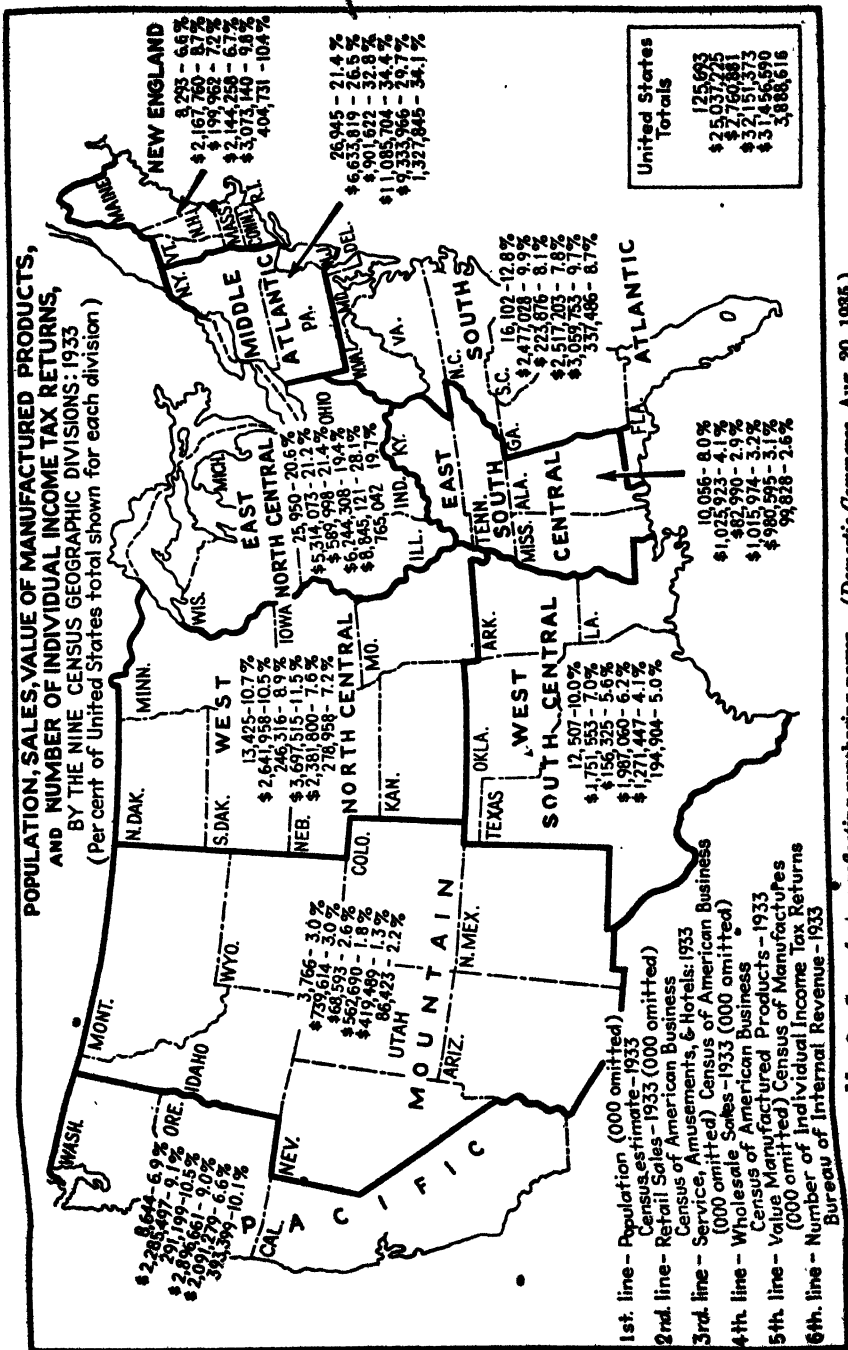
THE NATURE OF MARKETING

TABLE 12.—PER CAPITA SALES THROUGH INDICATED KINDS OF STORES, BY GEOGRAPHICAL DIVISIONS, FOR 1929 AND 1933¹
(Expressed to the nearest dollar)

Geographical division	Totals		Food stores		Eating places		Farmers' supplies and country general		General merchandise		Apparel stores (in- cluding shoes)		Automotive (except filling stations)		Filling stations		Furniture and house- hold (including radio)		Lumber and building material (including hardware)		Drug stores		Other stores		
	1929	1933	1929	1933	1929	1933	1929	1933	1929	1933	1929	1933	1929	1933	1929	1933	1929	1933	1929	1933	1929	1933	1929	1933	
United States.....	404	199	89	54	17	11	30	12	53	31	35	15	23	64	23	15	12	23	8	32	11	14	8	32	13
New England.....	467	261	123	84	19	13	20	10	60	37	43	22	24	72	28	13	12	24	10	31	12	15	10	47	24
Middle Atlantic.....	490	246	126	78	25	17	17	7	63	38	56	25	31	62	23	11	9	31	10	32	10	14	8	51	20
East North Central.....	450	205	102	55	19	12	20	9	64	34	39	15	25	72	23	18	14	25	7	39	12	15	9	35	14
West North Central.....	398	197	69	43	15	11	45	18	50	29	27	12	17	71	25	19	16	18	7	47	16	14	9	25	11
South Atlantic.....	268	154	56	38	8	6	37	17	35	23	20	10	41	41	19	12	11	14	6	17	7	10	7	17	8
East South Central.....	221	102	39	23	7	4	46	16	28	16	13	6	37	32	7	7	11	4	14	5	9	5	11	5	5
West South Central.....	310	140	51	30	11	6	45	16	38	22	18	8	60	21	15	11	16	5	28	9	14	8	13	5	5
Mountain.....	421	166	78	45	16	10	47	21	53	30	23	9	86	29	18	14	20	6	39	13	15	9	27	11	11
Pacific.....	553	264	115	67	31	17	31	12	71	42	45	18	106	37	23	19	34	10	39	14	19	12	39	15	15

¹ Adapted from *Census of American Business*, U.S. Department of Commerce, 1933.

² Total column figures do not exactly correspond to sum of distribution columns because of the fact that cents were dropped and only the nearest dollar used.



MAP 2.—Some factors reflecting purchasing power. (Domestic Commerce, Aug. 20, 1935.)

The Quantity Element in Demand.—How much people will buy depends, as was stated above, on their *ability* and *willingness* to buy. An indication of how much will be purchased may be secured by studying buying habits and by estimating the amount people spend for certain articles and services. The amount that a person will buy at any given time, assuming he is able to buy, depends upon (1) whether prices are rising, falling, or stationary; if prices are rising he will tend to buy for future use; if prices are falling he will tend to defer purchase until he actually needs the article; when prices are stationary he will buy for present and near future needs. (2) The influence of fashion; if the style is likely to change soon or frequently, the quantity bought is usually the minimum possible. (3) Ease of securing and the time required to effect delivery; if the source of supply is near or there are rapid transportation facilities, small quantities are bought; if there is danger of deterioration of the product, less will be bought at a time than if the product is relatively non-perishable.

The quantity purchased is indicated by several different sets of data. One indicator is the sales of the different kinds of stores. Department stores accounted for more than 10 per cent of total retail sales in 1933, although the sales of this group of stores declined 41 per cent from the 1929 figure. The ratio of food-store sales to total retail sales was 27.1 per cent in 1933. The total dollar volume of sales of this class of stores declined 37 per cent from 1929 to 1933, but the general price level of foods declined 36.4 per cent during the same period. The physical volume of sales therefore, apparently, actually declined very little.

Buying habits with reference to physical quantity are indicated by the data presented in Table 13. These data, collected by the Toledo Scale Co., furnish the weights of typical purchases in butcher shops and in grocery stores.

TABLE 13.—WEIGHTS OF PURCHASES IN BUTCHER SHOPS AND GROCERY STORES¹

Weights	Percentage of sales	
	Butcher shops	Grocery stores
Less than 1 lb.	24.92	16.66
1 lb. to 1 lb. 15 oz.	38.79	32.05
2 lb. to 2 lb. 15 oz.	18.09	20.64
3 lb. to 3 lb. 15 oz.	8.25	12.29
4 lb. to 4 lb. 15 oz.	3.87	4.89
Total	93.92	86.53

¹ Published in *Business Week*, Dec. 22, 1933. The study was made in six cities—Albany, Birmingham, Denver, Detroit, Duluth, and San Francisco. A total of 19,544 weighings in butcher shops and 12,728 in grocery stores were secured.

Approximately 90 per cent of the sales in butcher shops were in less than 4-pound lots, and more than 63 per cent were in less than 2-pound lots. The highest percentage for any lot was 38.79 per cent for the 1-pound to 1-pound 15-ounce group. Less than 7 per cent of sales were in units of more than 5 pounds. The grocery sales units tended to be somewhat heavier than the meat sales. Almost a third of the sales were in units of 3 pounds and above.

The following table, compiled from the *Census of American Business*, indicates how much the average consumer spent in each kind of retail outlet. Approximately 40 cents out of each dollar of purchases in this group of stores was spent in a department store; approximately one-fourth of this amount was spent in variety stores. Women's ready-to-wear stores and furniture stores each received only slightly less. Radio stores received the smallest proportion. This fact is easily understood, since radios are durable goods and one instrument is sufficient to meet the needs of the average family. The per capita unit purchase did not decline as much as the dollar figure indicates owing to the drastic price reductions of this instrument during 1932 and 1933.

TABLE 14.—PER CAPITA CONSUMER PURCHASES FROM TWELVE KINDS OF RETAIL STORES IN 1933¹

Department stores.....	\$20.19
Variety, 5 and 10, etc.....	5.40
Men's and boys' clothing and furnishings.....	3.89
Family clothing.....	1.47
Women's ready-to-wear.....	4.58
Shoe stores.....	3.38
Furniture stores.....	4.40
Household appliances.....	1.58
Radio stores.....	0.91
Cigar stores.....	1.51
Hardware stores.....	3.89
Jewelry stores.....	1.39

¹ Computations from U.S. Department of Commerce, Bureau of the Census, *Census of American Business, Retail Distribution*, 1933.

The Relation of Buying Habits and Income.—With a given income, how will a family choose to spend it? What particular kind and quality of goods and services will it buy, and how much will it be willing to pay for them?¹ The family, in order to survive, must have a certain minimum quantity and quality of necessities in the form of food, clothing, and shelter. There is a decided tendency for a family to consume these

¹ Willingness to buy, which is influenced by the standard of living, must, of course, be present; willingness, however, without purchasing power does not make purchasing possible.

items more abundantly as the income increases.¹ Thus greater variety and better quality are enjoyed; merchandise and services in the luxury class are purchased; and savings are accumulated. Table 15 presents an estimate of average expenditures for food, the home, attire, other living needs, and savings, by non-farm families with the indicated classified incomes up to and including \$20,000 a year.²

TABLE 15.—UTILIZATION OF FAMILY INCOMES¹
(Non-farm families)

Income class	Average expenditures ²				
	Food	Home	Attire	Other living	Savings
0 to 1,000	360	250	110	110	—60
1,000 to 1,500	490	360	180	210	10
1,500 to 2,000	610	470	250	310	100
2,000 to 2,500	700	580	300	470	180
2,500 to 3,000	770	690	350	640	280
3,000 to 3,500	820	820	390	800	400
3,500 to 4,000	860	960	450	960	510
4,000 to 4,500	900	1,110	490	1,120	620
4,500 to 5,000	920	1,250	530	1,260	780
5,000 to 6,000	940	1,460	590	1,480	990
6,000 to 7,000	970	1,720	680	1,770	1,320
7,000 to 8,000	1,000	1,930	760	2,050	1,720
8,000 to 9,000	1,030	2,100	820	2,280	2,240
9,000 to 10,000	1,060	2,290	900	2,500	2,720
10,000 to 15,000	1,150	2,620	1,040	2,980	4,270
15,000 to 20,000	1,300	3,600	1,400	4,300	6,600

¹ Cf. *America's Capacity to Consume*, op. cit., p. 257.

² These estimates do not include receipts by beneficiaries of insurance policies and funds drawn from savings accounts or contributions made to employees by their employers in the form of merchandise and services. The estimates of expenditures are confined to those paid out of the income actually received. Thus the expenditures for each class for the various items were, no doubt, higher than here given. Cf. *America's Capacity to Consume*, pp. 89 ff.

This table reveals some very interesting information with reference to the relationship of consumer buying habits to family income and to the indicated items of expenditures. The expenditures for each item

¹ *The Brookmire Economist*, Feb. 27, 1935, states: "People do, in fact, habitually spend about 90 per cent of their income."

² The aggregate income of 21,678,000 non-farm families in 1929, according to the Brookings Institution study, was almost \$70,000,000,000. The aggregate income of 5,796,000 farm families with incomes up to and including \$10,000 was approximately \$7,141,000,000. These farm families, which comprised approximately 21 per cent of the national population, received only 10 per cent of the national income. The income of the average non-farm family therefore was roughly 2½ times that of the average farm family.

increase in absolute amounts as the income increases, but the percentage of income spent for each item differs in the various income groups. The rate of increase in the absolute amount spent for food tends to decrease when the \$1,500 to \$2,000 group is reached. Thus the \$1,000 to \$1,500 group spends \$130 a year more for food—i.e., \$490—than the lowest class; the \$1,500 to \$2,000 group spends \$120 more than the preceding class, while the \$3,000 to \$3,500 class, for instance, spends only \$50 a year more than the \$2,500 to \$3,000 group. The expenditures for attire follow somewhat the same pattern, but not quite so definitely. The decline in the increase per year does not begin for this item until the \$2,000 to \$2,500 income group is reached, when the increase drops from \$70 to \$50. The total spent, however, is \$300, compared with \$250 spent by the next lower class. The expenditures for "home," "other living," and "savings" increase definitely as the income rises. The annual increases in the expenditures for the home amount to \$110 until the \$3,000 to \$3,500 income class is reached, when the amount of annual increase rises to \$130—i.e., from \$690 to \$820; for the next income class the increase goes to \$140, while the annual increase of the \$6,000 to \$7,000 class over the next lower class is \$260. The annual increase for "other living" expenditures is \$100 until the \$2,000 to \$2,500 income level is reached, and then the increase rises to \$160; for the \$6,000 to \$7,000 class the annual increase in expenditures above the next lower class is \$290. The annual increase in the amount of "savings" is very marked. The family, however, is apparently not able and willing to apportion as much as 10 per cent of its expenditures to savings until the \$2,500 to \$3,000 class is reached. The \$1,500 to \$2,000 class is able and willing to save annually, on the average \$90 more than the \$1,000 to \$1,500 class. The total amount saved, however, is only \$100. The \$6,000 to \$7,000 class saves \$330 more annually than the next lower class, or a total amount of \$1,320. The \$15,000 to \$20,000 income group saves 660 times as much as the \$1,000 to \$1,500.

The reader will note the similarity in the amounts spent by members of the \$3,000 to \$3,500 class for the following items: food, \$820; the home, \$820; other living, \$800. The similarity of expenditures for home and for other living is very marked from this level to and including the \$10,000 to \$15,000 group, after which the expenditures for the latter item increase much faster than for the first. The amount for savings takes first position when the \$10,000 to \$15,000 income group is reached and rises rapidly thereafter. These figures indicate very clearly that a larger and larger amount of expenditures in the higher income brackets goes for savings, other living, and the home. This practice may be explained by the fact that the quality and quantity attributes of items in these classifications are flexible, thus furnishing greater opportunity for conspicuous spending.

Although these data indicate how an increased income might be apportioned by the consumer to the indicated classes of purchases, we are still unable to determine the amount, the quality, the style, brand, and other important characteristics of the goods wanted. Consider food, for instance; will it be more meat, bread, and potatoes or will cakes, fruits, fowl, and caviar be added or will quality of the old kinds be purchased? In the case of clothing, will the added income be spent for more clothing, better quality and style, greater variety, or more frequent purchases? Only a detailed study of family budgets can furnish reliable answers to these questions.¹

Another indicator as to how families on different income levels choose to spend their money is given in Table 16. Although this represents a very limited study, the results are suggestive of what may be the situation in many other localities.

We note immediately the wide variation in purchases of the different items. The volume of purchases of several items does not increase at all in relation to size of income, while in the case of other items the volume of purchases increases in a much higher ratio than the increase in income. This situation is clearly demonstrated by comparing the \$10,000-and-over income group with the \$2,000-and-less group. Although the first group has more than five times the income of the latter, it spends less than twice as much for electric irons, toasters, vacuum cleaners, washing machines, radios, groceries, and telephone service. Volume sales of such items therefore are limited more by the number of families than by the size of the income. The purchases of new cars, oil burners, electric ranges, sterling and silver-plate silverware; the amount of money spent for sports and hobbies; and the volume of credit purchases at department stores increased as much as the income or more.² The expenditures for gas, electricity, and telephone services did not increase so much as the income.³

A report prepared by the Children's Bureau of the Department of Labor, published in 1935, shows that the laboring classes altered their diets as their incomes declined by reducing both the quantity and quality of meat consumed, largely eliminating eggs, fruit, fresh vegetables, and milk, and substituting oleomargarine for butter. There was a

¹ Cf. Chap. XIII.

² The purchases of silverware by the high income groups, for instance, were approximately sixteen times as great as by the low one; credit purchases in department stores were fifteen times greater; the purchases of oil burners were almost twenty-four times greater, of ironing machines forty times as great, and the expenditures for sports and hobbies sixteen times as much.

³ The information presented in the table tends to support the contention that a sales tax on durable consumer goods and other consumer goods except the simple necessities of life would not be so inequitable as is sometimes believed.

BUYING MOTIVES, CUSTOMS, AND PRACTICES

marked tendency toward greater congestion of living quarters. One-fifth of the families surveyed shared living quarters with homeless relatives and friends. The consumption of clothing and fuel was likewise curtailed.

TABLE 16.—INFLUENCE OF SIZE OF INCOME ON CONSUMER BUYING PRACTICE, 1931¹

Items	Income groups				
	Under \$2,000	\$2,000 to \$3,000	\$3,000 to \$5,000	\$5,000 to \$10,000	\$10,000 and over
Number of cars owned bought new (per 1,000 families in the group).....	384	752	917	1,122	1,434
Frequency of purchase per car-owning family, one car every.....	4.4 years	3.8 years	3.1 years	2.5 years	2.5 years
Total dollar volume of all building permits per 1,000 families.....	\$193,158	\$300,869	\$389,542	\$946,642	\$1,197,235
Oil burners in houses built by occupant, per 1,000 families.....	13	17	73	137	309
Automatic refrigerators, units per 1,000 families.....	20	45	52	99	104
Electric irons per 1,000 families.....	939	918	924	951	954
Vacuum cleaners per 1,000 families.....	699	928	965	950	955
Electric toasters per 1,000 families.....	451	726	792	792	788
Washing machines per 1,000 families.....	671	711	719	780	776
Ironing machines per 1,000 families.....	11	38	132	222	442
Electric fans per 1,000 families.....	117	334	453	570	610
Electric heaters per 1,000 families.....	86	265	360	394	421
Electric ranges per 1,000 families.....	23	63	64	125	156
Radios, number of sets per 1,000 families	668	912	900	935	986
Average monthly grocery bills (exclusive of fresh meat, poultry, fish, eggs, milk, and cream).....	\$ 29.35	\$ 36.94	\$ 41.65	\$ 49.22	\$ 53.35
Clothing for men or boys over 14 per 1,000 families.....	\$49,594	\$104,813	\$135,945	\$196,127	\$251,176
Sterling & silver-plate silverware per 1,000 families (2 years' total).....	\$ 1,961	\$ 9,950	\$ 8,927	\$ 18,340	\$ 32,036
Sports and hobbies, total year's expenditures for 12 sports per 1,000 families ² ..	\$ 2,572	\$ 8,291	\$ 17,159	\$ 29,424	\$ 40,471
Electricity, kilowatt-hours per year per family.....	772	741	975	1,045	1,639
Gas, cubic feet per year per family.....	25,444	22,343	28,347	33,146	63,569
Telephone, per cent of families with telephones.....	75.8	98.8	100	100	100
Credit purchasing 1930 with 4 leading department stores per 1,000 families.....	\$20,746	\$ 78,157	\$131,326	\$215,778	\$317,719

¹ Adapted from "Markets by Incomes," Vols. 1 and 2, *Time*.

² Twelve sports and hobbies used: golf equipment, hunting equipment, fishing tackle and equipment, boating, tennis, riding, skating, skiing, ping pong, playing cards, photography, and amateur movies.

Summary.—The amount of the money income of the individual family places a limit on, but does not necessarily determine, the volume of consumption. The family may not choose to spend its income for goods and services. The producer, in attempting to measure his potential market, must therefore take into consideration the willingness to buy. We have

learned that there are a number of factors affecting the buying habits, customs, and practices of the consumer. He has a number of motives for buying. When his want or desire for a particular good or service becomes greater than his desire to save or than his wish for some other good or service whose possession or use he must forego in order to secure the satisfaction from the first, he will probably buy if he can finance the purchase. Industry, merchants, and institutions are governed by different motives, generally speaking, from those that impel consumers in their buying. Non-consumer buyers tend to be much more rational in making their purchases. The motives of the consumer are highly personal and tend to be governed by emotion. Such factors as age, sex, marital position, and religion are important factors in governing the buying mood. Those catering to the wants of the consumer must consider his idiosyncrasies with reference to fashion, time and place of purchase, price, and quality.

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Questions for Discussion

1. Explain how "willingness to buy" influences individual purchases. Can you suggest an index by which the "mood to buy" can be measured?
2. How does the consumer exert his "control" over the producer and the seller?

3. Give examples showing how purchases are affected by (a) race, (b) age, (c) sex, (d) size of income, (e) occupation, (f) size of family, and (g) geographical location of the family.

4. "Human behavior is not rational but is determined largely by the environment or circumstances in which man happens to be placed. It is a product of an unstable and irrational complex, or reflex actions, impulses, instincts, habits, customs, and fashions." If these statements give a true picture, what is the effect of this situation upon the *how* and *why* people buy?

5. "It follows from the principle of *diminishing utility* and the endeavor of the consumer to derive the largest possible satisfaction from his income that whether he buys a commodity or not and how much he buys depends upon (a) the size of the income, (b) the relative expected satisfactions and his habits in buying commodities, and (c) the prices of this and other articles." Do you agree with this statement? Justify your answer.

6. "As applied to demand and supply, both the principle of indifference and the marginal principle influence the actions of buyers and sellers." Explain the meaning of *principle of indifference* and *marginal principle*. Explain how each operates in a marketing transaction so as to show the effect upon the market price.

7. Under what conditions and to whom are calculations with regard to elasticity of demand of practical importance?

8. Is the market demand for a commodity likely to be more or less elastic if it has many possible uses? If there are many possible substitutes for it?

9. "The elasticity of demand of an individual for a commodity depends upon (a) the slope of the utility curve for that commodity, (b) the slope of the utility curves of the other commodities, and (c) the prices of the other commodities." Illustrate.

10. "The question as to why the consumer is sold and not merely permitted to buy is a most significant one." Why does this situation exist? Do you think conditions would be satisfactory if sellers abandoned all sales-promotion activities?

11. "The consumer does not only demand goods but his buying habits and preferences force those who sell to him to perform a number of functions." Is this a true statement or do the practices of the seller determine the buying habits of the consumer?

12. "Even a superficial study of the subject will reveal two distinct types of buying motives, primary and selective." "Primary and selective motives may each be either *emotional* or *rational*." Interpret the meaning of this statement. Do you think these two classifications comprehend all buying motives? Give illustrations of emotional motives; of rational motives.

13. "Further evidence of the power of society over the consumption of the individual is found in the arrangement of the consumption of many persons." Give examples illustrating this fact.

14. "The lower ranks ape the higher, and the display in some of its forms reaches the very lowest ranks." Indicate the significance of this practice. Are fashions a social evil? How does the vogue affect marketing costs?

15. What is conspicuous consumption? Give illustrations. Show how the desire to emulate affects buying practice.

16. "The goods which the consumer purchases fall quite readily into three classes when considered on the basis of his buying habits." What are the characteristics of each class? How does this classification reflect the buying habits of the consumers? How do these habits affect the marketing organization of society?

17. "Anything that interferes with competition may result in breaking up the market. The chief interferences with competition are (a) custom, (b) combination, (c) sympathy, (d) fear, (e) ignorance of conditions, and (f) governmental action or interference, such as bounties, subsidies, tariffs, and many other things." Show how each of these affects the market.

18. "If it were not for the necessity of future sales, in most cases, the selling of goods would proceed on an absolutely unscrupulous basis. The consumer would be cheated or sold shoddy goods wherever possible. Even the necessity of future sales does not completely protect him." Do you agree with this point of view? Why is the consumer so helpless? What can be done to aid him?

19. "Consumers are often exploited because they lack knowledge of the market or are unable to judge the qualities of goods offered to them there." What can and should be done about it?

20. It has been predicted that the population of the United States will become stationary by 1950. The demand for what classes of products will be most affected? How will this changed demand affect our economic, social, and political problems? Be specific, indicating clearly causes and results.

21. "As population increases, the relative importance of certain talents or occupations changes and, in consequence, the powers of these groups to consume." What changes in the relative importance of occupations do you suspect will take place if our population becomes larger?

22. "If we take a little time to reflect we cannot fail to be profoundly impressed by the sweeping changes that have been made in our buying habits during a single generation." What are some of the more important changes? Account for these changes.

23. "The demand of consumers may be studied by three principal methods: (a) experimental studies in sampling the market, (b) a consideration of changes of rates of expenditure as shown by the cost-of-living studies, and (c) by statistical studies of the past relations between quantities produced or sold, and prices." Evaluate each method; indicate, also, the limitation to each.

24. Do you believe that industrial buyers and merchants always act in a rational manner in their purchasing and that consumers are always governed by emotion and habits? Justify your answer.

Assignment¹

1. Problem 1, p. 3. James McPherson—Consumer Buying Habits.
2. Problem 3, p. 9. Angier Corporation.

¹ *Suggestions to Students.*—All problems assigned in this text are found in Copeland, *Problems in Marketing*, fourth revised edition. The following outline suggesting a method of analyzing each problem may assist the student in preparing a logical report.

A METHOD OF ANALYSIS

- I. The problem or issues involved:
 - a. The objectives to be attained. (What are they?)
 - b. The conditions existing.
- II. The solution of the problem:
 - a. The plan devised. (What was done?)
 - b. Distinctive features of the plan.
- III. Results attained:
 - a. Specific results.
 - b. General results.
- IV. Criticism of the plan and its execution:
 - a. Defects.
 - b. Strong features of the plan.
 - c. Alternative plans.

CHAPTER IV

• MARKETING FUNCTIONS

Purpose of this chapter: To isolate, identify, and discuss the major marketing activities necessary to supply the demand for merchandise and services.

We have discussed, in the three preceding chapters, some of the characteristics of the demand for merchandise and services. We learned something about the varied wants and desires of the individual and the importance of the possession of purchasing power. The process by which and through which society distributes its goods and services among its individuals, industries, and institutions is quite complex. A number of important services or functions must be performed in transferring goods of the desired amount, quality, style, price, and other attributes from the producer to the buyer. Many of our most troublesome problems of marketing are directly related to the performance of these services usually referred to as marketing functions. The costs of marketing, about which so much is said in the press, on the platform, and over the air, are made up chiefly from the costs involved in performing these services. Improvements in marketing have usually come about through developing more effective ways to perform the services necessary in marketing tangible goods and services. The tendency toward constant change in marketing policies, organizations, and methods has been and still is one of the characteristic features of our marketing system.

The Marketing Process.—The individuals and firms operating in the field of marketing are engaged in creating and in adding time, place, possession, and other utilities to economic goods as they are moved along from producer to final user. The marketing process comprises two major activities—the *concentration* of economic goods and their *distribution* or dispersion.

We may think of concentration as that activity in which goods flow from many producers toward a central point or market, and distribution as that activity in which merchandise flows from a large reservoir in a more or less central location toward a large number of ultimate users. It is necessary to collect the products of forest, mine, sea, farm, and factory from the many producers located in different parts of the world. There are exceptions to this general statement in certain instances where integration has taken place. An automobile manufacturer may own ore and coal mines; a newspaper publisher may own forests and paper mills.

If these firms produce enough raw material from the owned sources to meet their needs, collecting and concentrating is not necessary for these particular products; yet few firms, if any, own the sources of supply of all the materials used in their businesses, so the generalization that concentration is one of the major marketing activities is accurate. The need for this activity arises from the practice of specialization prevalent in modern industry and from the differences in location of sources of raw materials, supplies, and labor, on the one hand, and the location of the demand for these goods, on the other. The activity of concentration calls for the performance of one or more of the following services: *buying, financing, risk bearing, and the adjustment functions, viz., transportation, storage, determination of quantity, standardization, and grading.*

After goods have been assembled or collected, it is usually necessary to distribute them to the ultimate buyer. As in the case of concentration, there may be some exceptions, *e.g.*, where integration has taken place. Raw materials may be collected directly from the producers by manufacturing firms, while the finished products made from such raw materials are sold to wholesalers who serve as concentrating agencies for a large variety of manufactured goods. The wholesaler will then disperse the goods to retailers who in turn distribute them among the users. Producers, in other instances, may sell direct to retailers or to the ultimate users.

The performance of the dispersion activity calls for one or more of the following services: *selling, financing, risk bearing, and the adjustment functions, viz., standardization and grading, transportation, quantity determination, and storage.* It will be noted that each of these services, with the exception of buying and selling, may be necessary in the performance of both concentration and dispersion. Buying is the primary activity in concentration, while selling is the activity emphasized in dispersion.¹ These various services are usually referred to by business men and economists as *marketing functions*.² These functions may be

¹ The reader will, of course, realize that buying cannot take place unless some one sells and that a sale cannot be executed unless some one buys.

² There are some minor differences among textbook writers as to the number of services classed as *marketing functions*; *e.g.*, Weld, Cherington, Ivey, and Clark each list the following seven functions: assembling, storing, assumption of risk, financing, rearrangement (standardizing and grading), selling, and transportation. There are slight differences in nomenclature. Vanderblue mentions ten functions, including, in addition to the seven listed above, buying, dispersing, and assorting. Macklin names eight functions: assembling, grading, packaging, processing, transporting, storing, financing, and distribution. He, however, divides distribution into two parts—selling and dividing—so that he really includes nine functions. Converse lists eight functions: buying, selling, dividing, standardizing and grading, transporting, storing, assembling, packing, plus the general business functions of reporting, financing, and risk taking. Breyer presents the following functions: quality determination,

grouped under three major headings: (1) purchase-sales functions; (2) adjustment functions; and (3) facilitating functions.

The marketing process

Concentrating

1. Purchase-sales functions

Recognizing and determining needs, desires, their qualities, and other characteristics

- a. Buying { Determining *what* will satisfy the needs
| Securing ownership of what is desired

2. Adjustment functions

- a. Transporting
b. Storing
c. Standardizing and grading
d. Quantity determination

3. Facilitating functions

- a. Financing
b. Risk bearing

Dispersing

1. Purchase-sales functions

- b. Selling by means of { Personal selling
| Advertising
| Mail soliciting
| Demonstrating
| Displaying
| Installing
| Packaging
| Identifying

2. Adjustment functions

- a. Transporting
b. Storing
c. Standardizing and grading
d. Quantity determination

3. Facilitating functions

- a. Financing
b. Risk bearing

The Purchase-sales Functions.—Since the primary objective of the marketing process is the transfer of ownership, the performance of the buying and selling functions is highly significant.¹ The buying function presupposes a need or desire, a mood for buying, and purchasing power. The function comprises all those activities involved in determining needs and what will satisfy them; seeking out sources of supplies; testing for quality, style, appropriateness, and other desired attributes; and the negotiation of terms of purchase and payment. Considered from the selling point of view, contacts must be made with prospective users, the good must be dressed, placed on display, demonstrated, its merits called to the attention of prospective users and buyers, and other appropriate steps must be taken to develop and encourage purchases.

The Buying Function.—The buying function, as indicated above, comprises all those activities involved in determining the demand or need for the product or service, determining the fitness of the good for the use

storage, contactual, negotiatory, measurement, packing, transportation, financing, payment, and risk bearing.

¹ For an interesting discussion of the marketing functions consult F. W. Ryan, "Functional Elements of Marketing Distribution," *Harvard Business Review*, pp. 205ff., January, 1935. Dr. Ryan breaks down the orthodox classification of functions into a large number of subclassifications.

contemplated, and then the business transactions necessary to complete the transfer of title from the seller to the buyer—in short, securing the ownership of the desired good. The buying function culminates in collecting, concentrating, and assembling the desired or needed amount, variety, and quality of goods. When this buying is for resale, it is necessary that the wants of the ultimate user or purchaser be accurately anticipated. Wholesalers, for example, may collect or assemble merchandise of great variety from all parts of the world and then sell it in relatively small quantities to retailers who in turn resell it to the consumer. The buying function would be a very expensive operation, indeed, if the small dealer had to travel long distances to many different places to select the desired merchandise. Many of the independent retailers have formed cooperative buying organizations for the express purpose of reducing this cost and securing quantity discounts on their purchases. The meat packers, textile mills, and wholesale fruit dealers could get their hogs, cattle, cotton and wool, fruits and vegetables, as their requirements dictate, by sending buyers throughout the land to contact the individual farmers. The cost of this method of buying, however, would be prohibitive. Live stock, fruits, cotton, wool, and grain are usually bought from the small local producers and concentrated in fairly large amounts at the local shipping points. These products are shipped to the large central market in carload lots where large-scale concentration provides adequate volume and variety of kinds and qualities. The buying function then promotes efficient marketing by concentrating products in large enough quantities to reduce the per unit costs of transporting, storing, financing, and assorting according to quality and quantity.

The buying function aids the consumer as well as the producer. Instead of the consumer having to go directly to hundreds of producers in order to satisfy his daily wants, he goes to a conveniently located retail store. The executives of these stores have thousands of products of different kinds, sizes, styles, and qualities from which the consumer can conveniently make his selections. The retail and wholesale merchants send buyers throughout the world looking for merchandise they think the consumer at home will purchase. These goods of wide variety are assembled in rather large quantities by importers, wholesalers, retailers, and other marketing agencies at convenient places and are sold eventually in small quantities to the consumer. It is obvious that the buying function makes it possible for the consumer to purchase merchandise which he would not be able to secure if he had to go to the various parts of the world where the goods and the materials from which they are made originate. Since the articles are bought in large quantities by experts who know values, the costs are much lower than they would be if this buying activity were performed by the ultimate user.

Determining the Fitness of the Product.—It is always necessary for the buyer to determine certain facts about the characteristics of the merchandise. He may wish to know, for instance, whether the style and quality of the goods will meet his need or whether the machine will perform to his satisfaction. Many other questions, depending upon the buyer, the product, and the use to be made of it, will probably arise in the mind of the prospective purchaser. How does the typical buyer meet the situation?

There are three methods commonly used in determining the fitness of an economic good for any given use. They are by *inspection*, by *sample*, and by *description*.

Inspection is necessary when dealing in non-standardized, 'ungraded, and highly perishable products. Live stock is usually bought only after careful inspection by the buyer. Articles bought because of their style, design, or other special quality are bought only after inspection. This method is used when the product cannot be adequately described or sampled or the buyer does not have confidence in the description or sample given by the seller. Buying by inspection, however, tends to be expensive; it is frequently inconvenient and should be abandoned in favor of some more effective plan when and where feasible.

A *sample* can be used satisfactorily when products are graded into uniform lots according to quality, size, and other significant physical characteristics. Purchase on the basis of a sample is in reality a modified form of inspection. Its use depends to some extent upon the confidence the buyer has in the honesty and good faith of the seller. It is assumed in the sales negotiation that the sample displayed is truly representative of the bulk. Many agricultural, natural, and manufactured products as well as perishable services are bought and sold on the basis of samples. The plan is more economical, for obvious reasons, than the inspection method. Its successful use requires, however, a higher standard of business honesty and confidence.

Purchase on the basis of *description* has grown rapidly during the last several years. It is more economical than either of the two other methods. This method demands the highest type of business conduct; honesty and confidence are absolutely necessary. Description makes possible future trading on organized exchanges and sales by catalogue and letter. Standardized terminology can be developed so that a buyer in one part of the world can tell a seller in another part what he wants and then be sure of having his need satisfied. The mail-order houses have developed the art of communicating description, by means of words and pictures, to a high degree of perfection. Buyers and sellers operating on the organized exchanges make constant use of the method; millions of dollars are spent annually by manufacturers to describe their

products. The purchase of equipment, supplies, and merchandise on specifications illustrates a specialized use of description.

The buying function is not completed until the title to the desired good has been transferred to the purchaser. This phase of the buying function may comprise a number of business details, such as filling out order blanks, keeping records, checking invoices, and any other routine acts involved in facilitating payment and the transfer of ownership. The performance of the buying function assumes the ability to pay or to make satisfactory terms.

This brief discussion, it is believed, will serve to demonstrate why the buying function is a necessary marketing activity; why the ultimate consumer, industry, institutions, and all others who have to go to outside producers in order to meet their needs for the necessities and luxuries of life, and for raw materials, machinery, supplies, and services, benefit by the efficient performance of the services involved.

The Selling Function.—When considering the selling function our point of interest shifts to the seller. The selling function comprises all those activities utilized in determining the needs of the prospective and potential users, and in persuading them that the good will satisfy their needs and desires. The completion of the selling function involves the consummation of the sales-purchase contract whereby mutually agreeable terms are established and title is transferred. The seller in his attempt to win the patronage of the prospective buyer, usually employs such devices as personal selling, mail soliciting, advertising, and packaging; he may use the product in demonstration or through display; and he may give premiums and various forms of service, such as installation, delivery, credit, and repair.

The selling function is concerned with finding possible buyers and users, pointing out to them the desirable qualities of the merchandise and services offered for sale, and finally bringing about the actual consummation of the sale. The major objective of the selling function is to bring the buyer and the seller together in a trading mood so that an exchange of title to goods may take place with mutual advantage. If it were not for the activity of the seller in bringing to the attention of the buyer or prospective buyer knowledge of new products that will meet his needs and wants, the consumer might go for an indefinite period of time in ignorance of the existence of such goods. The incentive for the development of new and improved products would no doubt be reduced materially if producers were prohibited from using suitable and ethical means to inform prospective users. Machines are being continually invented which reduce the cost of production and lessen the drudgery of farm, home, office, and factory work; many contrivances are designed to bring happiness and pleasure to large numbers of people. The selling

function is concerned with the education of the possible users to an appreciation of these improvements. Frequently some one discovers new uses for old products; it is the task of the selling organization to bring this fact to the attention of present owners and prospective purchasers. The discovery of the valuable vitamin content of many foods is a good illustration.

Although people have recognized needs for food, clothing, shelter, and amusements, our competitively organized society does not leave the consumer to his own volition in seeking out the particular article or service to satisfy his wants. Producers have farms, mines, factories, and selling organizations which they wish to keep in operation. Capacity for production is frequently in excess of current demand. This situation leads to an intensive effort on the part of these producers to dispose of their goods and to keep their volume of output up to a point that permits economical production.

The performance of the selling function is probably the most expensive of all the marketing services. This is largely due to uneconomical competitive sales-promotional methods frequently used and to the lack of confidence in the product or seller on the part of the buyer. The buyers quite frequently believe that since the seller is in business to make a profit his selling activities are not without a considerable amount of bias. The practice followed by some sellers of making extravagant claims with reference to the quality and the performance of their goods causes the consumer to regard with suspicion and doubt the statements and the merchandise. These conditions tend to develop sales resistance on the part of the buyers. The buyers, instead of considering the sellers as authentic and reliable sources of information, may develop a tendency to raise objections and to present reasons why they should not purchase the particular merchandise or service. This situation in turn often causes one seller to renew and increase his selling activity in the hope of overcoming the prospective buyer's objections and of convincing him that the seller's product comes nearer meeting the consumer's needs at a lower cost than the product of some rival seller who is also making heroic claims. The net result of the entire situation frequently is an unreasonable increase in selling costs.

The selling function is essential in modern economic society even though the defects in sales practice mentioned above do exist. People should be informed concerning the use of new products for both old and new needs, new uses for old products, and the superior methods of production and of marketing used by a particular firm. It is a desirable as well as a necessary service to indicate to the prospective purchaser the place, the time, and the terms of sale under which a particular service or article of merchandise may be secured. Merchandise may be put up

in attractive and useful packages, and bulk merchandise must be divided and graded to meet the convenience and needs of the users. Some articles must be displayed and demonstrated, and some forms of machinery must be installed and serviced in order to meet the needs of the buyer and to secure sales.

During recent years some progress has been made in reducing the cost of performing the selling function. Salesmen are more carefully selected, more thoroughly trained, and more wisely supervised. Sales costs are being reduced or prevented from rising through the use of effective advertising. Modern advertising, in spite of its many defects and abuses, furnishes an admirable means of securing efficient mass selling. The performance of the selling function is being simplified through the integration of marketing agencies. This movement is exemplified in the rapid growth of the chains—both retail and wholesale—cooperative marketing organizations, and the mergers among certain types of producing and marketing agencies.

Adjustment Functions.—The completion of the marketing process usually requires a group of services involved in the physical handling of the goods. Their purpose is to make adjustments when certain deficiencies exist. These services are transportation, storage, standardization and grading, and quantity determination. Although these services are usually referred to as marketing functions, the reader will readily recognize that these services are not used exclusively in marketing transactions. The production process makes extensive use of transportation, storage, quantity determination, and standardization and grading. Raw materials, semi-manufactured products, tools, and many other objects used in and during the production process are moved from place to place and stored; many must be highly standardized as to size and quality so that they can be processed in the machines and so that the final product will have the desired degree of uniformity as to physical and chemical characteristics. These four services, however, are essential in such a large proportion of marketing transactions that custom has labeled them marketing functions.

Transportation provides *place utility*, which corrects the spatial maladjustment resulting from goods being produced in one place and used in another. Storage provides *time utility*, which corrects the time maladjustment resulting from goods being produced at one time or season and used at another time. The service of quantity determination may be regarded either as a part of buying and of selling or as a separate function, depending on the emphasis one judges this activity deserves. The writer believes that the analysis of the marketing process may be facilitated by regarding quantity determination as a marketing function. This service as such provides a *counting utility*, which corrects the quantitative malad-

justments resulting from goods being produced on a scale larger or smaller than they are consumed. It reconciles likewise the conflict, on one side, between the different scales of production, the requirements for economical handling secured through large-scale shipments, and storage, and the demand, on the other side, for small units by the ultimate consumer and for large volume by some industrial and institutional users. Standardization and grading provide *quality utility*, which corrects the maladjustment resulting from the lack of uniformity in production on the part of nature, workmen, and machines. All of these functions, it will be noted, deal primarily with the physical handling of the goods. The major objective in each instance is to provide adjustments which will remove some deficiency resulting from the production process or to meet some desire on the part of the user or buyer.

The Transportation Function.—The transportation function pervades the marketing process from beginning to end. From the sources of production of natural and agricultural products to the processing points and to the ultimate user we find the function of transportation playing an important role.¹ It is equally necessary in moving manufactured goods from the factory door to the warehouse and hence to the wholesaler, retailer, and, finally, to the consumer. The animal-drawn sled, cart, and wagon, the power-driven truck, railway car, water and air ships; the pipe line, power transmission, telephone and telegraph wires, and pneumatic tubes; and even human beings—all are used to aid in moving goods and services along from the producer to the final user.

Facilities for efficient and economical transportation determine the location of industries and markets. The railroad made possible the rapid development of the Mississippi Valley by providing quick and economical access to the seaports; when the steamship displaced the slow-going and less dependable sailing vessel, international trade on a large scale sprang up; the development of the refrigerator car and ship made it possible for the inhabitants in large sections of the world to supply their wants for fresh meats, fruits, and vegetables the year round. The gasoline truck, automobile, and good roads are important factors in bringing about changes in our marketing methods and organizations. A properly organized and administered transportation system widens the market and permits a high degree of geographical specialization in agricultural and industrial activities.

¹ The center of hog production, for example, has been moving westward more rapidly than the center of population, thus requiring a longer haul to market. Thus in 1840 they were 150 miles apart, in 1890 they were 220 miles apart, and in 1930 they were 280 miles apart. The center of population in 1930 was near Linton, Ind.; the center of hog production was 280 miles west near Sigsbee, Mo. The tendency for production centers to move farther from the center of population creates a greater need for more transportation and storage services.

The individual producer is very much interested in transportation rates, since the price he will receive for his product is likely to be the central market price less the transportation charge from the point of shipment to the central market. Thus if wheat is selling on the Chicago market at \$1.25 a bushel, a farmer in South Dakota will receive approximately \$1.15 a bushel, assuming the freight rate from South Dakota to Chicago to be 10 cents a bushel.¹ The buyer likewise is interested in the cost of transportation, since the central-market price must be high enough to bring a supply sufficient to meet the demand, and the market price will therefore reflect the cost of performing this service.

Transportation by Railroad.—The importance of the transportation function is suggested by the volume of freight originating on and carried by the Class I railroads. In the depression year 1921, 39,323,158 cars were loaded with revenue freight, the tonnage amounting to 1,690,762,695 total revenue tons. For 1929, the peak of the prosperity era, 2,451,601,084 total revenue tons were carried in 52,827,925 cars. The year 1933 reflected the depression of this period; 29,220,000 revenue cars were loaded, and a total of 1,258,826,084 tons of freight were carried. Approximately 30,785,600 cars were loaded in 1933. The Class I railroads in 1934 moved almost 269,000,000,000 "ton-miles" of freight.² In 1929 the corresponding figure was in excess of 447,000,000,000 ton-miles. The revenue tonnage for 1933 was distributed among the various products as follows: products of agriculture, 81,702,027 tons; animals and animal products, 17,850,825 tons; products of mines, 395,064,720 tons; products of forests, 33,164,630 tons; manufacturers' and miscellaneous products, 157,009,486 tons; and l.c.l. (less than carload) freight, 14,350,763 tons.³

The following quotation indicates in a dramatic way the importance of transportation services in general and railway transportation service in particular in our economic society.

The passenger trains run a million miles a day, and 49,000 of us get aboard them in an average hour to swell the annual passenger-mile total to sixteen billions. Two million freight cars are in service, loading at the rate of 3,300 an hour even in dull times. In a year they carry a billion and a quarter revenue tons of cargo. In a year their trains travel 393,000,000 miles. Freight worth a billion and a half to its owners is daily in transit by rail.⁴

Transportation by Motor Trucks.—It is estimated that trucks hauled 50 per cent of the live-stock receipts in 1933. This is an increase from 42 per cent in 1932. The length of haul varied from 1 to 500 miles;

¹ We are ignoring, for the moment, the other costs and charges.

² One ton-mile means the transportation of 1 ton of freight for a distance of 1 mile.

³ *Yearbook of Railroad Information*, 1934 edition.

⁴ Robbins, L. H., *The New York Times Mag.*

the average haul was 85 miles in 1932 and rose to 100 miles in 1933. Fifty-four per cent of l.c.l. merchandise was moved by trucks in 1932. Twenty-six per cent was moved 1 to 50 miles; 22 per cent was moved 50 to 250 miles; and 6 per cent was moved more than 250 miles. The trucks of 190 firms, classified as common carriers, traveled 81,450,310 vehicle miles; those of contract carriers traveled 20,720,587 vehicle miles; and those of private owners traveled 141,252,930 vehicle miles. Of the tonnage of the common carrier group, 68.26 per cent comprised general merchandise; 48.59 per cent of the tonnage of contract carriers consisted of petroleum products; while 70.13 per cent of the tonnage of private owners consisted of miscellaneous goods. Some other products transported by trucks were livestock, milk, fruits, vegetables, cotton and other farm products, iron and steel products, building materials, paper and paper products, coal, tires and rubber, automobiles, furniture, and household goods.¹ One hundred railroads in the United States owned or operated 42,000 trucks in 1933. Some of the reasons, enumerated in the order of frequency of mention, given in 35,468 responses representing 112,142,038 tons of goods, for using trucks were store-door delivery, faster service, lower total cost, store-door pick up, more flexible or convenient service, cheaper packing, late acceptance of shipment, simpler classification of rates, and less damage and loss.²

Determination of Freight Rates.—It is said that a freight rate is economically correct when it permits a maximum flow of products to all markets and does not discriminate unjustly between geographical sections which are natural competitors.³ Articles of merchandise are grouped under certain classifications for transportation purposes, and a separate rate for each classification is established. The country is divided into a number of freight-rate territories. The classifications and rates may be and usually are different in each territory. The determination of a specific rate for any given classification is governed by some or all of the following factors: (1) the value of the product; (2) its physical characteristics, *e.g.*, size, volume, weight, degree of perishability, and services in transit needs—cooling or heating; (3) risks involved; (4) competition from other forms of transportation and the influence of competing markets—one city or district does not want a rival to get an advantage in rates over it; (5) actual or estimated costs of the service involved; and (6) what the traffic will bear. Common building brick, for instance, will not bear a high rate because the freight charges may soon exceed the value of the product. Raw silk, on the other hand, will stand

¹ Cf. *Merchandise Traffic Report of the Federal Coordinator of Transportation*.

² *Ibid.*, quoted from 1934 edition, *Automobile Facts and Figures*, p. 25.

³ "Railway Rates and the Geographical Location of Slaughter," Armour & Company, *Monthly Letter to Animal Husbandmen*, Vol. VII, No. 8, p. 4.

a relatively high rate and still move halfway around the world because of the high value, light weight, and small bulk of the commodity.¹

Trucks have been able to move large volumes of freight over short distances because of their flexibility, convenience, and lower costs. They have been able to move some classes of freight long distances in competition with the railroads because society furnished them with a free roadbed, and the operators were not forced to pay the high wages and some other costs paid by the railroads.

Transportation Services.—The marketing of all economic goods, with the exception of real estate and certain forms of services, demands a consideration of the character of the transportation services best suited to the particular case. There are three major forms of services available—express, mail or parcel post, and freight. Each is designed to meet certain definite needs. It is necessary likewise to select the transportation agency that will perform most satisfactorily the type of transportation desired, *i.e.*, waterway, railway, highway, pipe line, cable, or airway. Having decided upon the character of the transportation needed and the kind of agency or agencies best suited to perform the services, the next step is to determine the route the goods are to follow from producer or seller to buyer or user. The factors that generally receive attention in selecting the route are (1) the line haul and delivery costs, (2) the speed, (3) the facilities of competing routes, and (4) the comparative service advantages.²

Transit Services and Privileges.—Reconsignment, which allows the through rate from the point of origin of the shipment to the place of final destination, is one of the more important and frequently used transportation privileges. This privilege allows a change in billing or in car movement or both; *i.e.*, permission is given to change the name of the consignor, consignee, owner, destination, or route. The possible reasons for a shipper's desire to make use of the reconsignment privilege may arise from certain unknown or unforeseen market conditions; thus the demand in a number of central markets may be unknown or uncertain. Perishable goods, such as fresh fruits and vegetables, cannot be held; they must be moved toward a market before they begin to spoil. Other goods, such as coal and oil, may not be stored economically at the point of production; consequently, it may be desirable to start these products moving before a definite market has been selected. It may be learned after a

¹ According to one study, the average freight car of the country carries 25 loads a year. Eleven per cent of the total time is spent in moving freight; 38.7 per cent in switching and interchanging; 26.8 per cent in loading and unloading; 9.4 per cent for Sunday and holiday and other delays and for reconsignment; 9 per cent for repairs; and 5 per cent in idle time due to no business.

² BRYAN, L. A., *Industrial Traffic Management*, pp. 351-353.

shipment has been started, but before it has reached its destination, that the market to which it was consigned is oversupplied and that prices are not satisfactory. The privilege of reconsigning the car so as to send it to another market may be of real economic value in preventing a scarcity or a glut in a particular market.

Other privileges, such as milling, mixing, fabricating, and finishing in transit, are important in the marketing of such goods as grain and steel products. The privilege allows the through rate on products that may be stopped at some point for processing or manufacturing purposes. Under certain conditions cars may be stopped to be partially unloaded, or the contents of two or more partially loaded cars may be concentrated in one car. This arrangement allows the through rate from the source of shipment to final destination. Since the car-lot rate is always less than the l.c.l. rate, a considerable saving in freight costs may be secured.

The Peddler Meat Car.—Peddler refrigerator cars, so effectively operated by the meat packers, make use of a special *in transit* privilege. They are loaded at the packing plants and sent out over designated routes on regular schedules. These cars, which have been packed so that the meat for the first town reached is near the doors and the meat products for the last town on the route are in an end of the car, stop at the various towns on the route and leave a supply of meat for the local retailers. The orders have been taken previously by a salesman representing the packing house. The general practice of the carriers is to charge the regular l.c.l. rate with differing guarantees being exacted from the shipper as to carload minimums of weight or of revenue. This type of service benefits the consumers in small towns, the meat retailers, the packing firms, and the farmers.

Chart II illustrates the use made of car route service by one large meat packer.¹ This company has 50 meat packing plants located in the live-stock-producing areas; 110 plants devoted to the preparation of poultry, butter, and eggs; 375 branch houses in the principal cities of the United States; and 1,000 car routes which reach the smaller towns and country districts. It also has many branches and agencies abroad.²

Miscellaneous Transportation Services.—In addition to the transportation services mentioned above, there are certain terminal services and privileges performed at the point of shipment or at destination. The more important classes of this kind of service are (1) terminal switch-

¹ Yearbook 1929, Swift & Company, p. 35. The motor truck, however, is now being used quite extensively to make store-door delivery of meat directly from the packing plant. This method of delivery apparently is practicable within a distance of 100 to 125 miles of the place of slaughter. This practice reduces the use of the refrigerator car to the extent that the truck is substituted.

² Conny, J. E., *Printers' Ink Weekly*, p. 16, Aug. 1, 1935.

ing, (2) lighterage, (3) cartage and store-door delivery services, and (4) trap- or ferry-car service. The ferry car is a car which is placed upon the private siding of a shipper, where it is loaded with l.c.l. shipments, and then pulled to the local transfer station by the carrier so that the contents can be handled as circumstances demand. Competition among transportation agencies is tending to extend store-door delivery, which is the reverse of the trap-car service. The use of freight containers and of store-door delivery offers some economy in transportation through

A Typical Car Route Service Arrangement

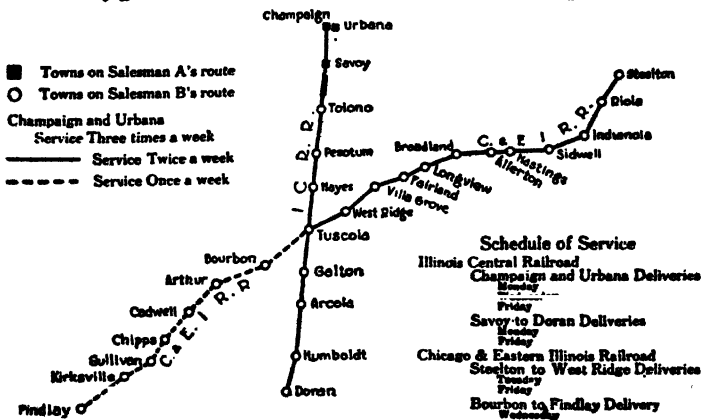


CHART II.

reducing the time it takes to move the goods from the producer to the buyer and through reducing handling, packing, and possible demurrage charges.

The Storage Function.—Goods have to be stored at every step through the marketing process. In an ideal marketing system there would be a continuous stream of goods flowing without delay or interruption along the route from the producer to the ultimate user. Storage, however, aids in the real situation by making adjustments between irregularities in production and in demand.

The time, quantity, and quality of production of agricultural goods are affected by the seasonal element. Practically all of the late potatoes and apples of the country are harvested within a period of two months. The wheat, corn, and cotton crops are harvested within a relatively short period of time. Butter, eggs, and poultry are produced in much larger quantities in the spring and summer than in the winter months. In order that we may have these products, and many others, during the when they are not being harvested, it is necessary to store them.

Because the production or transportation of certain natural products, such as iron ore, petroleum, and coal, is affected by weather conditions, large supplies have to be transported during the open season and stored at the point of manufacture to be processed during the winter season. Some products have to be stored a period of time so they will properly cure or become fit for consumption. Examples of products that require this treatment are cheese, bananas, tobacco, certain grades of lemons, and beef.

The character of the demand makes storage necessary for all types of merchandise. The manufacturer frequently wants a supply of raw material on hand or ready to select from so that he will be assured of a sufficient supply of the proper quality to keep his plant in operation. The consumer expects the retailer to have in stock the goods he desires at the time he wants them. The retailer looks to the wholesaler or the manufacturer to supply him promptly with merchandise when he orders it. The rapid growth of cities has made the storage function more important than in colonial days. The changed ways of living have intensified this importance. Improved methods of storing have aided in the extension of the service.

Kinds of Storage.—There are two classes of storage, common and controlled. Common storage is the type that is in universal use. The farmer stores some of his produce on the farm—in the barn, granary, cellar, and smokehouse. The merchant stores his merchandise in his place of business and in his warehouse. Wheat and corn are stored commercially in elevators; coal may be stored in huge open yards; petroleum, in large metal tanks; and a factory may store its raw materials and finished goods in open yards and in warehouses. The housewife stores small amounts of groceries, fruits, vegetables, and canned goods in the kitchen, pantry, and fruit room. Such commodities as wheat, corn, cotton, hay, coal, and lumber require large volumes of storage space, yet the type of service rendered is simple and relatively low in cost.

Controlled storage, on the other hand, is neither simple nor cheap. By controlled storage is meant an arrangement whereby the temperature and humidity of the products in storage can be kept at a desired point; *e.g.*, fruits, vegetables, and eggs, in northern latitudes during winter, must be kept from freezing. This may require heating. The greater amount of effort is expended, however, in keeping the heat out. Cold storage has been in use many years to prevent the rapid spoilage of perishable articles. The markets for fruits, vegetables, fresh meats, oysters, and fish have been greatly extended through the development of cold-storage facilities. The refrigerator car, which furnishes cold storage in transit, was a remarkable development. Mechanical refrigeration made large-scale cold storage possible. Now eggs, poultry, and fresh

meats may be kept in a wholesome condition for indefinite periods of time. More recently, electrical refrigeration for the home, the perfection of "dry ice," and the development of the quick freezing processes have favorably influenced the marketing of a number of perishables. It is now possible to ship fresh fish from the Atlantic seaboard to the Middle West and fresh fruits and vegetables from California and Mexico to Chicago and New York. These improvements have made possible the storage of many commodities once classed as strictly perishable and at the same time have lengthened the storage period of others.¹

The costs of storage have been reduced through specialization and large-scale operation. Retailers are reducing their storage activities as much as they can by buying in small quantities, keeping their stocks low, and increasing their turnover. Specialized independent warehouses, located at strategic points, perform on a large scale some of the important storage functions formerly assumed by the retailers, wholesalers, and manufacturers; being specialists, they give better services at lower cost than the small merchants and manufacturers could provide for themselves.² In addition to the strictly storage function these public warehouse organizations perform such important services as delivery, transportation, record keeping, repacking, and giving credit information.³

The following statement indicates the growing importance of certain forms of storage and the reasons for this trend.⁴

The hand-to-mouth buying tendency and the resulting demands for quick delivery on the part of both retailers and wholesalers has made it necessary for the manufacturer to establish spot stocks at various strategic points.

The trend toward different types of wholesalers, from large general wholesalers to smaller specialty jobbers, cash and carry jobbers, and wagon jobbers, is increasing the importance of the public merchandise warehouse in distribution. Manufacturers must make spot stocks available in order to furnish quick and efficient service.

In the distribution of commodities which, due to their nature, are not the most susceptible to public merchandise warehouse distribution, savings in transportation costs may more than offset the added cost of using this type of distributive agency.

Storage of Poultry Products.—Statistics show that more than one-half of the total egg crop for the year is produced during the four months of

¹ ERDMAN, H. E., *American Produce Markets*, Chap. XVII.

² There were, according to E. E. Ferebee, 1,162 public merchandise warehouses in 1928, with available storage space of 33,037,000 square feet. They received 7,823,678 tons of merchandise, 75.5 per cent of which was stored to some extent.

³ FREDERICK, J. H., *Increasing Your Sales through the Use of A.W.A. Public Merchandise Warehouses*.

⁴ FERELEE, E. E., *Journal of Business of the University of Chicago*, Vol. VI, No. 4, pp. 318 f., October, 1933.

March, April, May, and June, and that the total receipts of dressed poultry in the four principal markets of the country for the three months of November, December, and January almost equal the total receipts at these markets during the nine other months of the year.¹ Before the inception of cold storage, wide variation in market receipts resulted in successive glut and famine. Farmers suffered from the extremely low prices during the period of high production, while the consumers paid an extremely high price or did not use eggs during the several months of

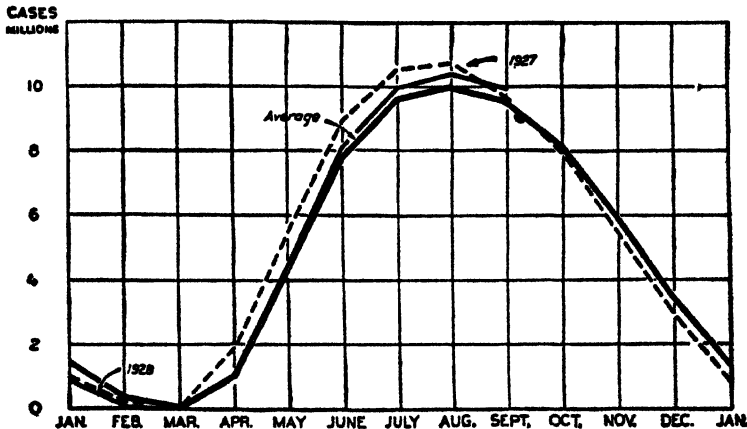


CHART III.—Cold-storage handling of case eggs, by months, 1927, and January to September, 1928, and 5-year average, 1923-1927.²

low production. The development of cold-storage facilities changed conditions. Buyers now bid against each other during the production season so as to get a supply of eggs and poultry to put in storage. They keep the prices from falling to the low levels formerly reached. These supplies are put on the market during the period of low production and thus keep prices from going as high as formerly. Cold storage in this way tends to stabilize prices to the advantage of both the producer and the consumer.

During 1926, 10,000,000 cases of eggs, valued at almost \$80,000,000, were stored. This amount was 13 per cent of the value of the entire egg crop. There were in addition 50,000,000 pounds of frozen eggs broken from the shell, valued at \$11,500,000.¹ The value of stored poultry for the same year was equal to \$44,000,000, or 8 per cent of the total value of the poultry raised.

The peak of egg storage, as indicated in Chart III, is reached by the first of August; then withdrawals increase until January when the supply

¹ EEDMAN, *op. cit.*

² "Cold Storage of Eggs and Poultry," U.S. Department of Agriculture, Circ. 73, p. 2, June, 1929.

is usually exhausted.¹ The peak of poultry storage is generally reached in February, while September usually finds the supply exhausted. More space is used in public warehouses for the storage of eggs than for any other one commodity, with the exception of apples. Frozen poultry ranks fourth.²

The principal storage centers for eggs and poultry are located in the Middle Atlantic and East North Central states. This location is determined by the large centers of population in these regions. It has been found more satisfactory from a marketing standpoint to store perishable and semi-perishable products near the points of consumption rather than near the places of production.

The cost of storing eggs varies according to conditions and type of warehouse. The representative cost per dozen for 30-cent eggs for a period of eight months is about 4.34 cents, distributed as follows:

	Cents
Warehouse charges per dozen.....	2.1
Interest on investment at 6 per cent.....	1.2
Interest at 15 cents per \$100.....	0.04
Estimated depreciation and loss.....	1.00
Total cost at time of delivery.....	4.34

Without counting the depreciation cost, the carrying charge amounts to 3.2 cents per dozen, or 11 per cent of the original cost of the eggs. The storage costs on poultry in percentage terms are practically the same.³

Quantity Determination.—The function having to do with the determination of quantity, sometimes called rearrangement, comprises two divisions. One division has to do with collecting, concentrating, and assembling goods in the desired quantities; the other has to do with the "breaking of bulk"—dividing of the larger quantities into the smaller divisions desired by the small-scale producer, the retailer, and the consumer.

Many agricultural, natural, and manufactured products are produced by large numbers of small-scale producers scattered over a wide geographical area. Some are produced in foreign countries. One phase of the quantity-determination function is to assemble these goods into such size quantities as to meet the needs of large-scale users; to provide an adequate variety in style, size, quality, and price range from which the prospective buyer may choose; and to furnish economical handling units. There is a tremendous small-scale demand scattered throughout

¹ *Ibid.*, p. 8.

² *Ibid.*, p. 4.

³ *Ibid.*, p. 47.

the country and, in many instances, throughout the world, for a large variety of goods. This act of supplying the appropriate quantities is designated dividing. The butcher divides the beef carcass into half-pound, pound, and other size units to meet the wishes of the housewife; the grocer weighs out 1, 5, or 10 pounds of sugar and various size units of fruits, vegetables, flour, butter, and so on. The wholesaler, for example, may buy in large lots, sometimes carloads, and sell to the retailer, perhaps in one- to five-case lots. The milk dealer collects milk by the truck load and sells it to the consumer by the half pint, pint, and quart. Throughout the business world we find the application of the quantity-determination function. Automobiles may be bought in train loads by the dealer and sold as single units to the consumer; gasoline, in tank-car lots and sold by the gallon; coal, by the boat load and sold by the ton. The same principle applies to clothing, drugs, hardware, furniture, and many other articles too numerous to mention.

Quality Determination.—This classification comprises the two closely related activities of grading and standardizing.

Grading is the process of dividing a quantity of the same kind of goods into uniform groups according to certain standards of quality, size, shape, color, texture, degree of cleanliness, acidity, or other significant characteristics. When a particular grade has been established and is commonly recognized and used, it is said to be standardized. The purpose of standardization is to give a grade the same meaning any time and any place it is used.¹ Thus the well-known established grades for cotton, wheat, and many other products denote the same qualities in the international markets.

The Economic Value of Grades and Grading.—It is commonly recognized that nature does not produce objects of uniform qualities. Consumers and industries have a great variety of definite wants and needs to be satisfied. There is then a decided demand for some agency to select

¹ The Committee on Definitions of the National Association of Teachers of Marketing recommended the following definition: Standardization involves (1) the determination of basic limits or grades and (2) the establishment of model processes and methods of producing, handling, and selling goods and services. These basic limits or grades determine the specifications to which manufactured goods must conform and the classes into which the products of agriculture and the extractive industries may be sorted.

J. V. Coles describes standardization and its application as follows: Standardization may be described as the process of discovering and making available information concerning goods which will enable consumer-buyers to make intelligent comparisons and rational choices. This information may be quantitative or non-quantitative in character. It is made available to the buyer by describing goods through labels, advertising, and sales talk in terms of commonly understood words, phrases, symbols, and the like or through units of measurement, ratings, and grades, i.e., in terms of standards.

the sizes and qualities of goods wanted and to place them on the markets. Goods not wanted should not be produced. Since grading makes it possible to separate the products of nature and of agriculture into groups according to the needs of the different kinds of manufacturers, institutions, and consumers, the costs of transportation, storage, selling, buying, financing, and risk bearing may be materially reduced through its skillful use. To be more specific, a manufacturer of fine cotton cloth needs a certain quality of cotton fiber; if he can buy this raw material after it has been carefully graded by experts, he saves time and energy. Accurate grading makes it possible for the retailer catering to an exclusive clientele to buy the quality desired by his trade. If the grading had not been performed previously he would have to take, for instance, apples as they came from the trees in different sizes, shapes, colors, and perhaps different kinds. He then would have to take out the ones suited to his trade and dispose as best he could of the others. The cost of rehandling and of reselling and the loss due to deterioration would greatly increase the costs of marketing. When grades become standardized, sales by sample and description are possible. The way is opened for the use of advertising. Grading facilitates long-range and future trading and makes possible the publishing of market-price quotations. It permits the combining of different lots of the same kind of product when they are of the same grade, thus making it possible to utilize to the fullest extent storage and transportation facilities. This is especially important in marketing the grains.

Determining Specific Grades.—The determination of specific grades for any given product depends upon a number of factors. The most important factors seem to be the characteristics of the buyer and the nature of the use. Thus when the consumer buys for personal use, his individual likes and dislikes as well as his utilitarian needs must be considered. Grades must reflect his wishes with reference to color, size, texture, degree of cleanliness, and the like. Two varieties of apples, peaches, or strawberries may have the same characteristics with reference to size, flavor, and other qualities with the exception of color. The housewife would be likely to discriminate against the one with the pale color in favor of the one with the rich "strawberry" hue. The manufacturer, on the other hand, might not be so particular about appearance but would be interested in size and chemical content. Low-grade, bruised, small, misshapen, and off-color apples and oranges may be sent to presses where the juices are extracted, whereas those of uniformly high quality may be stored or sold on the produce market. Large quantities of high-quality eggs, butter, and poultry are placed in storage during the spring, summer, and autumn months, while the less desirable units are disposed of immediately.

Lack of Uniform Terminology.—An effective grading system presupposes a nomenclature which is easily recognized and understood by the user. Much of the possible benefit from standardization and grading is unavailable to the consumer, owing to the use of misleading and confusing terms. A reported statement of a division of the Consumers' Advisory Board furnishes some interesting illustrations of this situation.

"U.S. No. 1" cheese, which might be mistaken by consumers for top quality, actually rates third grade; "fancy" apples are usually top grade; "fancy" brooms are second. The designation "standard" applies alike to third grade canned fruits and fifth grade dried fruits. A "No. 1" mirror is not the best grade of mirror on the market, "AA" and "A" ranking above it. "A1," a term generally implying excellence, is given to the lowest grade of silverware. For many important commodities, such as gasoline, specific descriptions of quality exist, but are not available to consumers.¹

The Advisory Committee to the Administrator for Industrial Recovery, in discussing the drafting of standards, grading, and labeling provisions for the canning code stated:

In the absence of a more simple and logical scheme of quality nomenclature, your committee inclines to the belief that "Grade A," "Grade B," "Grade C," etc., or "Grade 1," "Grade 2," "Grade 3," etc., are terms best suited for information labeling purposes. We feel consumer needs will be met by the inclusion on canned food labels of the following information:

(1) A concise, truthful statement of grade. (2) Such additional explanatory statements as style of pack, count of pieces, size of units, number of servings, as may be appropriate for the product.

We believe it to be in the interest of both industry and the public to adopt the principle of quality standards and grade labeling, and to proceed with its application as rapidly as enforceable grades are promulgated.²

There are government grades for a number of products.³ American Cheddar Cheese, for example, is graded for flavor, body and texture, finish and appearance, and color. The different grades and their meanings are as follows:

Grade	Score
U.S. Fancy.....	92, 93, or 94
U.S. No. 1.....	89, 90, or 91
U.S. No. 2.....	86, 87, or 89
U.S. No. 3.....	83, 84, or 85

These grades are stamped on the product when inspected and graded by government officials.

¹ *New York Journal of Commerce*, Oct. 3, 1934.

² *Ibid.*

³ For example, butter, cream, cheese, meats, live stock, grain, cotton, lumber, coal, fruits, canned goods, and others.

Canada enacted a law in 1918 which required that all cans of fruits and vegetables, whether domestic or imported, be carefully inspected and marked for grade of quality. There are four grades, *viz.*,

Fancy: As nearly perfect as possible, packed from sound, clean fruit or vegetables at perfect maturity and free from blemishes, of good colour and uniform in size. The workmanship must be good and the liquid must be clear.

Choice: Allows slight variation in size, colour, and maturity, but must be packed from fruits and vegetables which are sound, clean, and free from blemishes. The liquid must be fairly clear.

Standard: All fruit and vegetables must be of good quality and good maturity, although they need not be uniform in size or colour. The liquid must be fairly clear.

Second (of which practically none appears on the retail market): Must be packed from clean, sound fruit or vegetables, but absolutely lacks uniformity.

Performance of the Function.—It is generally conceded that the function of grading should be performed as near the point of production as possible. The quantity to be graded, however, should be large enough to permit economical operation. The candling and weighing of eggs, for example, cannot be economically performed by the farmer producing only a few dozen a week; neither can the local dealer, who buys only two or three cases a week, afford to buy the apparatus needed or take the time to perform this function. The man producing a small quantity of apples or oranges cannot afford to buy a sizing machine. Manufactured goods, on the other hand, produced under modern machine methods, do not have to be graded. The machine turns out a standardized product when given raw material of uniform quality.

Products may be graded in the fields as gathered, at the packing sheds and central packing houses, at the shipping point, in the central markets, and at the factory where the products are used as raw materials. The character of the product, the conditions under which it is produced, the degree of complexity of the grading process, and the facilities available for grading are determining factors as to where the function should be performed. The sooner the undesirable products are separated from those desired, the lower will be the costs of storage, transportation, financing, and spoilage. The following quotation from Professor Coles's book² states in a very clear manner the social importance of adequate standards and gives illustrations of ill effects to the consumer resulting from questionable sales-promotional practices indulged in by some sellers.

¹ *Domestic Commerce*, May 10, 1935.

² COLES, JESSIE V., *Standardization of Consumers' Goods—An Aid to Consumer Buying*.

In the field of consumers' goods, standardization may be described as the process of making available in commonly understood terms such information concerning characteristics of goods as will permit their identification and comparison in the market. Such identification and comparison make it possible for the consumer-buyer to secure the goods best suited to a particular use with a minimum expenditure of time, effort, and money. The common use of standards which aid the consumer-buyer has an important bearing on the production and purchase of consumers' goods. It is of benefit to consumers and producers; to sellers as well as to buyers.

The present-day producer not only devotes his energies to providing goods from which consumers may select, but he expends considerable effort in telling them about these goods in an attempt to induce them to buy. This service is necessary in order that consumers may know what goods are available and where to obtain them. On the other hand, efforts of producers to guide demand to their particular goods have led to activities which confuse consumers and make buying difficult. The producers' desire for profits leads them to resort to practices which may be actually fraudulent. And for the most part, consumers do not know that they are being deceived. Modern technique of production is such that consumers are unable to distinguish differences in goods.

Irrelevant statements are made concerning goods, such as those featuring the fact that "Carnation" milk comes from contented cows, and that "Ivory" soap floats. By implication and suggestion consumers may be led to infer the presence of characteristics which are merely fictitious. Trade names may be misleading. "Beanhole" beans are not prepared in beanholes. "Nu-grape" beverage is not made from grapes. "Belgen" sheets are not made in Belgium or of linen. Of 100 textile trade terms submitted to 600 women buyers in all parts of the country, 38 were found to be misleading, 23 confusing, and 5 "more or less" misleading.

Philippine mahogany is not genuine mahogany. Hudson seal is made from muskrat skins. Silk may be weighted two or three times its original weight with metallic substances.

Unfortunately, however, the information provided concerning specific characteristics of goods in many cases lacks exactness and definiteness; therefore it is of negligible value to the buyer. This lack of exactness is in part due to the scarcity of accurate and commonly understood terms by means of which information may be expressed. The producer sometimes does not wish to supply such information or is not able to do so because he does not know the exact facts concerning his goods. Especially is the latter true of retailers, although the practice of buying goods according to specifications and the use of testing laboratories provide means by which they are able to know more of the essential facts concerning goods than formerly.

It is recognized, of course, that all products cannot be top grade, yet there may be a market for all that are produced. The purpose of grades is to designate the quality standards of the goods offered for sale. The label on canned goods should indicate to the consumer in a definite and easily understood manner the quality and quantity of the contents.

It is equally true that even a good system of grading and labeling cannot relieve the buyer of his own responsibility to use common sense and ordinary judgment in making his selections. He should not hesitate too much to put forth the effort necessary to prepare himself to perform his domestic or business buying duties.

Facilitating Functions.—The financing and risk-bearing functions facilitate the performance of the marketing process. •The buying and selling of goods under present-day conditions require the use of large quantities of money and credit. The provision of financing services to facilitate the marketing transaction is an important business activity. Modern living and buying habits of individuals, production methods of factories, farms, mines, and institutions, and general political, economic, and social forces, as well as the forces of nature generate and transmit a large number of risks that greatly affect marketing organization, policies, and practices. The administration of the marketing process is greatly facilitated through an effective control of these risks.¹ Whether we class these two services as marketing functions or as independent business activities which facilitate the performance of the marketing process does not seem, to the writer, to be of particular significance. The important fact for the student of marketing to understand is that a very close relationship exists between the effective buying and selling of goods and the satisfactory performance of these two services.

The Financing Function.—Modern methods of production and marketing consume a considerable amount of time from the beginning of the production process until the finished product reaches the user. Generally speaking, the consumer, from whom the payment for the product is received, will not advance the money for the payment of the article until it is delivered. Provision for supplying the funds necessary to market the ~~good~~ must be made. The service of providing the credit and money needed to pay the costs of getting merchandise into the hands of the final user is commonly referred to as the financing function of marketing. There was little need for this service in a simple economic society, such as the English manor or an early American frontier settlement. Today, with our roundabout methods of production and extensive market areas, some one has to finance the transaction until the buyer pays for the product he purchases. The farmer, the manufacturer, and other producers and the various types of middlemen must pay rent, insurance, and transportation costs, buy equipment, and make other expenditures before receiving payment for their goods and services. Some merchandise is produced during only a few months of the year but may be used more or less continually throughout the year. The excess production

¹ The reader will immediately recognize the fact that risk bearing and financing are just as important in the production process as they are in the marketing transaction.

must be stored and put on the market as the buyers make their purchases. This storage must be financed. The farmer who sells eggs in the spring to some shipper does not want to wait for his money until January when the eggs may be taken from cold storage and sold to the consumer. Again, a consumer or an industry may need certain products now but may not have the money to pay for them at the present time. The man who buys a home, the farmer who buys a farm, and the industrialist who buys equipment for his factory usually make payments on these purchases throughout a number of years. If there were no means for financing these types of purchases by some form of long-term credit, sales would be greatly restricted. It is evident that there is a genuine need for the financing service.

There are many different sources of finance. The more familiar ones are the commercial banks, commercial paper houses, loan companies, finance companies, individual persons and firms, and, since 1933, the Federal Treasury on a large scale, through the Farm Credit Administration, the Home Owners' Loan Corporation, and several other agencies. The financial service may be given to the producer, to the merchant, or to the buyer. The specific financial needs will depend, in any given case, upon the character of the product, the characteristics of the buyer, the relative locations of the producer and of the buyer, amount and quality of marketing services necessary to get the product from the producer to the user, and the nature of the marketing organization established to perform the various functions.

To supply the financial needs, some one must save, *i.e.*, abstain from spending and consuming. Since it seems to be a common human characteristic to consume in the present, the people who do abstain from immediate consumption expect some remuneration for the sacrifice. This remuneration is commonly called *interest*; it adds to the cost of marketing, which in turn is reflected in the price of the commodity. Thus the consumer or final buyer pays the cost of financing the marketing transaction. He is willing to pay this expense, however, because of the service received.¹

Market Risks.—The ownership of property carries with it certain risks. Since marketing has to do with the transfer of ownership, it is obvious that risk and risk bearing are involved. Risk is the result of uncertainty—uncertainty as to *what* may happen or *when*, *where*, or by *what* agency it may transpire. Changes in consumers' tastes are the sources of many market risks. A manufacturer may produce a large quantity of shoes of a certain color and style which are much in demand when he develops his production schedule. By the time these goods

¹ A discussion of the policies and practices affecting market finance is given in Chap. XVI.

are set before the ultimate consumer his desire may have switched to some other fashion so that it is impossible for the producer to dispose of the shoes except at a great loss. The retailer has a similar risk to meet. If he fails accurately to anticipate the changing desires of his clientele, he "runs the risk" of great financial loss.

Changes in prices frequently occur at unexpected times, thus causing severe losses to owners of goods purchased for resale. The period 1929-1933 furnishes scores of illustrations of this situation. Decreases in the price of raw materials frequently cause loss to manufacturers who find it necessary to reduce the price of the finished article below the cost of production. A new product, the result of an improved process or recent invention, may put competing products in the obsolete class. Perishable goods are likely to deteriorate and spoil while on their way to the ultimate user. There are risks from possible theft, bad debts, loss of purchasing power on the part of the buyers, due to business depressions, poor crops, and other causes. Other risks arise from such causes as storms, earthquakes, weather changes, fire, wars, and strikes; and from insects and diseases that attack farm animals, fruits, and crops.

There are various possible methods of dealing with marketing risks. Certain risks may be eliminated, some may be transferred, while others may be mitigated by different means. The development of cold storage, for instance, has practically eliminated the risk of spoilage—within reasonable limits—of many perishables. Insurance companies, for a fee, assume certain types of risk under definitely specified conditions. Thus the producer and merchant may transfer to a specialist the function of risk bearing with reference to such possibilities as loss from fire, storm, floods, and theft. It is obvious in these instances that the risks have not been eliminated although they may be reduced. Insurance companies, by assuming risks on a large scale, are able to spread the losses among a large number of policy holders and consequently to perform the function at less cost than the individual producer or merchant. Producers, merchants, and manufacturers are able, through hedging on an organized produce exchange, such as the Chicago Board of Trade, to transfer a portion of the risks of changes in the prices of certain products to specialized traders. These speculators have unusually good facilities for securing market information; they have the skill, secured through experience, needed to interpret the information, and the financial resources to deal in future contracts. As a result, risks of loss from price changes are probably lessened as well as transferred. The rapid growth of business and market research; the great improvements in methods of transportation and communication which make possible the more effective gathering and dissemination of market news; and the widespread utilization of the discoveries and inventions of the sciences, all

have tended to reduce many market risks. The careful attention given to the character and trend of the wants and desires of the consumer with reference to the changes in fashion has reduced the losses from this source.¹

Miscellaneous Activities.—Some students of marketing list a much larger number of so-called marketing functions, including such business activities as recording, record keeping, accounting, establishing contact with possible buyer or seller, negotiating the terms of sale or purchase, distribution, dispersing, dividing, assembling, processing, packaging, and packing. While all of these activities may be performed in executing the marketing transaction, the present writer believes that many of these activities, *e.g.*, record keeping, recording, and accounting, are managerial activities employed in the control of the business and should not be classed as marketing functions. Establishing contacts and negotiating terms appear to be parts of the buying and selling functions rather than separate and distinct functions. It would be difficult indeed to perform either the buying or selling function without establishing contact and carrying on negotiations with reference to the terms of sale. Distribution, apparently, is another name for either transportation or marketing. Dividing and assembly are the two component parts of the quantity-determination function as we have defined it.²

Some writers list *processing* as a marketing function. Fruits and vegetables are put through a process when they are canned; live stock are processed when they are slaughtered and the meat products put on the market. To the author, this so-called function is in reality a production or manufacturing activity rather than a part of the marketing process. The primary purpose, undoubtedly, is to give *form* utility; the case is not different in principle from the production of innumerable other manufactured articles.

Packaging, while an important marketing activity, may logically be classed as a subdivision under the major heading selling. This service is performed for the convenience of the buyer with the hope that he will purchase a particular product, grade, or brand. It is primarily a sales-promotional effort and is a result, largely, of the competitive situation.

The buying and selling functions are necessarily performed in each marketing transaction. What particular function or functions of those remaining that need to be performed in any given instance is determined by such factors as the characteristics of the product, the location of the producer, the method of production, the characteristics of the demand, competition, and the policies of the management.

¹ A more extended discussion of marketing risks is given in Chap. XVII.

² See also R. F. Breyer, *Marketing Institutions*, Chap. I.

Summary.—The activities required to perform the marketing process may be grouped under eight major classifications designated as marketing services or functions. The eight functions are buying, selling, transporting, storing, grading, quantity determining, financing, and risk bearing. These classes logically fall into three groups under the descriptive headings sales-purchase functions, which comprise the buying and selling activities; adjustment functions, which comprise the storing, transporting, grading, and quantity-determining services; and the facilitating functions, which comprise the financing and risk-bearing services. The existence of such services suggests the necessity for some organization, agency, or agencies to perform them. The presence of functions, in other words, indicates the existence of some operating structure. The three chapters immediately following discuss the elements of the modern marketing structure.

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1. *Business Week*, published by McGraw-Hill Book Company, Inc.
2. *Domestic Commerce*, published by U.S. Department of Commerce.
3. Daily newspaper.
4. Census reports.

Questions for Discussion

1. Explain what is meant by the terms marketing process, concentration, dispersion, sales-purchase function, adjustment function, facilitating function.
2. How do the buying problems of the ultimate consumer differ from those of the industrialist? The merchant?
3. What activities does the selling function comprise? What part does this function perform in the transferring of title?
4. "There arise four types of maladjustments which require correction by some part of the marketing mechanism." What are the maladjustments and what marketing functions correct them?
5. The relation between transportation and marketing is very close. Indicate this relationship. What services are performed by transportation?
6. How are the demands upon transportation influenced by (a) the increased use of national advertising, (b) emphasis on a more rapid turnover of stock, (c)

emphasis on a desire for variety of goods, (d) emphasis on up-to-the-minute styles, (e) demand for special services?

7. "Actual and relative rates play an important part in the location of marketing agencies." Show by concrete examples how this works out in practice.

8. "There are many special features of freight service which have particular effects on the market structure." What are they?

9. "Other things being equal, the seller who has the lowest transportation costs on the materials, equipment, and supplies which he uses and on the shipment of his product to market can sell at the lowest price, makes the greatest net profit, and, if his supply is great enough, may even control the market." Explain fully the meaning of this quotation by giving concrete examples.

10. What is the effect of an increase in freight rates upon the position of the jobber? The manufacturer selling direct?

11. Why is it that the railway rate on particular articles often has little effect on the retail price of goods? Give illustrations.

12. What are the (a) advantages, (b) disadvantages of (1) freight containers, (2) store-door delivery to the shipper, the buyer, the railroad?

13. How does that part of the transportation cost paid for railroad freight compare with the amount paid for transportation by other agencies?

14. If goods are shipped via rail to New York to be sold, and while enroute the destination is changed to Philadelphia, the change in destination is known as _____. What is the name of the charge made by transportation companies for railroad cars left longer than the allotted time?

15. "One of the principal marketing functions is that relating to the storage of commodities." What are the chief reasons why storage is needed? Give illustrations.

16. "Conditions under which goods are stored are of three general types." What are the three types and the corresponding kinds of storage?

17. "In order to comprehend the problems of the storage of goods over comparatively long intervals an analysis of the services rendered by warehousing agencies is pertinent. These services involve (a) preservation of the goods, (b) assumption of liability, (c) inspection and grading, (d) labeling, packing, and packaging, (e) conditioning of the product, (f) financing depositors, (g) distribution service, (h) trucking, (i) miscellaneous services." Indicate, briefly, what services are implied by (b), (e), (e), (f), and (g).

18. "Probably the most important influence of storage is exerted on prices." Show just how storage affects price.

19. "It would be futile to ignore the fact that, with all these positive contributions to the economic system, storage has given opportunity for certain abuses." What are the chief abuses? How may they be prevented or eliminated?

20. What factors should be considered in determining (a) when to store; (b) where to store; and (c) who should perform the function?

21. What is the relation between *grading* and *standards*? Cite illustrations. "The basis for grading seldom reflects the convenience of either the producer or the seller." What determines the basis?

22. What is the difference between *grade labeling* and *descriptive labeling*? What groups favor each, and why?

23. "In studying the function of financing and risking, the marketing process may be divided into three periods: (a) the period prior to the products entering the regular channels of trade; (b) the period during which the products are in the hands of professional tradesmen; and (c) the period after the products emerge from trade channels." What are the chief classes of risk incurred during the marketing process? How may they be met?

24. "Market risk is due primarily to fluctuations in prices." Illustrate. "In most market transactions the risk involved is due to the passage of time." Show how the time factor affects risk.

25. How may market risks be prevented, eliminated, shifted, minimized? Cite specific instances.

26. Enumerate the marketing functions performed by (a) The Great Atlantic & Pacific Tea Company, (b) a local drug store, (c) Armour & Company, (d) a local motion picture theater.

PART II
THE MARKETING PROCESS

CHAPTER V

THE ELEMENTS OF OUR MARKETING ORGANIZATION— WHOLESALE MIDDLEMEN

Purpose of this chapter: To examine the structure designed to perform the major marketing functions; to analyze the nature of the services performed by the functionaries in the field of wholesale marketing; and to study their characteristics and methods of operation.

What are the elements of our marketing organization? What are the significant features of the structure that has evolved to perform the marketing functions and related services? While society was organized on a simple basis the producer and consumer dealt directly with each other; generally speaking, no so-called middlemen were required. As society became more complex, as specialization and division of labor became more highly developed, as producers began to collect raw materials from scattered districts and to sell their products throughout wide areas, and in small lots, marketing intermediaries of various kinds appeared between the producers and the consumers. These specialized agencies took over the performance of some of the functions previously carried out by the producers and the users and, in many instances, added other services found necessary due to the changing conditions that vitally affected production, communication, and consumption. The growing concentration of people in cities, the changing standards of living, and the increasing purchasing power of the family have created a need for some commercial organization comprising individuals, groups of individuals, and firms to perform more effectively the services of buying, selling, storing, grading, collecting, dividing, transporting, financing, and risk bearing. The majority of producers find it more economical to devote their major effort to production problems and to delegate the task of selling the merchandise to the agencies specializing in performing the marketing functions. The ultimate consumer likewise finds it more economical and convenient to patronize the retailer rather than to attempt to satisfy his wants by contacting the original producer and buying from him. A considerable volume of goods, it is true, is sold directly by the producer to the user, but this method has definite limitations as is shown later. When production is on a small scale, by a large number of producers scattered over a wide area; and when the goods are in universal demand, bought frequently and continuously in small

quantities at a low unit price, the marketing intermediaries have, generally speaking, a strong economic position based on the effective services they render to both producers and users. The explanation and the justification for the emergence, development, and continued existence of any given marketing functionary are, then, its ability to perform some service or group of services more effectively and satisfactorily than can the producer, the consumer, or some existing agency.¹

Component Parts of the Marketing Structure.—One or more of the marketing functions may be performed by the producer, the buyer, or the intermediary marketing functionaries. The farmer, for example, may individually or through his cooperative association perform all the services necessary to sell his goods to the ultimate user. A comparatively small amount of farm products, however, is so marketed. A producer of natural products, *e.g.*, a petroleum or a coal company, may perform all the services necessary to place his goods in possession of the ultimate user. Here again we find a relatively small amount so handled. A wide variety of manufactured goods is sold directly to the ultimate user by the producer; the major portion, however, passes through the hands of one or more intermediaries. By far the greater proportion of service, on the other hand, is sold direct by the producer without the use of middlemen.

We shall confine our discussion in this and the following chapter to a consideration of the marketing functionaries that operate between the producer and the user.² Our analysis and discussion may be somewhat simplified by classifying all the establishments operating in this sphere under two major headings, *viz.*, wholesale marketing functionaries, and retail marketing functionaries. The wholesale group comprises wholesale merchants, merchandise warehouses, agents of various kinds, and organized exchanges; the retail group comprises the various kinds of retail merchants, catalogue mail-order houses and other direct selling organizations, restaurants and eating places, and many establishments selling services.

The wholesale group typically buys in large quantities and sells in smaller lots, collects large quantities of like kind, and, in some lines, assembles a wide variety of qualities, sizes, styles, and colors. The firms in this group, in addition to buying and selling either on their own account

¹ This statement assumes a relatively long interval of time. There will be found at any given instance agencies that have outlived their usefulness, and new ones that will never secure a profitable position. Each of these groups will eventually pass out of existence. Their passing may be retarded because of legal protection, subsidies, and credit extended to them from outside sources.

² Those business firms, sometimes called *functional middlemen*, that specialize in providing certain services necessary to complete the marketing process are not included, *e.g.*, railroad and trucking firms, banks, and insurance companies.

or for others, may perform one or more of the other marketing functions.¹ The members of the wholesale group typically sell to retailers and to industrial users, but they may also sell to other wholesale middlemen and even to the ultimate consumer.

The retail group typically buys from members of the wholesale group, in moderate-sized quantities, and resells to the ultimate consumer. There are numerous instances, however, in which the retailer buys direct from the producer, and he may sell to wholesalers, producers, and other retailers.

The Economic Position of the Wholesale Functionaries.—The present and future existence of the wholesaler depends upon the effectiveness with which he performs certain services for the manufacturer and the producer, on the one side, and for the retailer, on the other.

The wholesaler is a specialist in marketing.² He is in constant contact with hundreds of sources of supply and of demand for goods. He is in a position to know what the retailers want, when they want it, and why. The manufacturer who distributes through the wholesale merchant can sell in large lots; frequently he ships a carload or more at a time to a single wholesaler. This reduces transportation and packing expense. The wholesaler then "breaks bulk" and usually divides and repacks in smaller lots to meet the needs of the retailer. Since the wholesaler buys in large quantities he also assists the manufacturer by supplying storage space nearer the points of final sale. Some wholesalers buy for future delivery and may even advance funds to the manufacturer or producer at the beginning of the producing season. In this way they become important factors in financing the producer. When a manufacturer sells direct to retailers he has to investigate the credit rating of a host of small dealers, keep thousands of small accounts, and run the risk of substantial losses through poor collections. The agency group in the wholesale field performs an economic service by acting as a representative for the buyer or the seller or both, who may be producers, merchants, or large-scale users. The use of the agent tends to save time and to reduce overhead costs in marketing. The wholesale middlemen, evidently, perform important economic services in the marketing of many kinds of goods.

¹ There are many wholesale establishments that engage in what the *Census of Wholesale Distribution* designated multiple-type wholesaling. According to the estimates, 2.7 per cent of the wholesale establishments surveyed in 1929 engaged in two or more separate and distinct types of wholesaling. The sales volume of this group was 6.6 per cent of the total wholesale business. Cf. T. N. Beckman, *U.S. Department of Commerce, Wholesale Distribution Series, W-251*.

² The Definitions Committee of the National Association of Marketing Teachers suggested, tentatively, the following definition of wholesaling: "The process of marketing goods to others than the ultimate consumer."

The manufacturer who produces on a large scale, is strong financially, and has a product that sells for a relatively high price and is capable of identification may find it desirable, under some conditions, to sell direct to the retailer or even to the ultimate consumer or user. When this is done the manufacturer must, through his own organization, perform the services normally furnished by the wholesaler.

The Volume of Wholesale Trade.—The *Census of Distribution* reported wholesale business of almost \$69,000,000,000 for 1929.¹ The volume for 1933, reported by the *Census of American Business*, was 53.6 per cent less, or an amount equal to \$32,030,504,000. Although there was a drastic decline in the volume of sales due to the depression (see Table 17), there was a very small decline in the number of establishments, i.e., a decrease of only 5,553, or 3.3 per cent. It is interesting to note, however, that a drastic decline occurred in the number of agents, brokers, assemblers, and country buyers, while the number of wholesale merchants and bulk tank stations increased materially. While the number of whole-

TABLE 17.—VOLUME OF BUSINESS OF WHOLESALE FUNCTIONARIES IN THE UNITED STATES¹

	Number of establishments			Net sales		
	1929	1933	Per cent change	1929	1933	Per cent change
Total.....	169,654	164,101	- 3.3	\$68,950,108,000	\$32,030,504,000	- 53.6
Wholesalers proper.....	79,784	82,844	+ 3.8	29,288,220,000	12,959,914,000	- 55.8
Manufacturers' sales branches.....	17,086	16,842	- 1.4	16,335,917,000	7,496,226,000	- 54.1
Bulk tank stations.....	19,611	26,176	+33.5	2,390,213,000	1,884,644,000	- 21.2
Chain-store warehouses.....	559	462	-17.4	1,929,681,000	1,431,663,000	- 25.8
Assemblers and country buyers.....	34,226	23,961	-30.0	4,749,382,000	1,756,903,000	- 63.0
Agents and brokers.....	18,388	13,816	-24.9	14,256,695,000	6,501,254,000	- 54.4

¹ Final U.S. Summary, *Census of American Business*, 1934.

salers proper increased, they lost in both absolute and relative sales volume (see Chart IV, page 125). In 1929 they accounted for 42.5 per cent of the total wholesale volume, but in 1933 they accounted for only 40.5 per cent of the total. Chain-store warehouses did 2.8 per cent of the business in 1929 but increased their share to 4.5 per cent in 1933. Bulk tank stations increased their percentage from 3.4 to 5.9 per cent. There was not on the whole, however, a very great change in the relative posi-

¹ These figures do not include sales of more than \$11,000,000,000 made direct to retailers and more than \$16,000,000,000 of sales made by manufacturers direct to industrial buyers.

tions of the various groups; bulk tank stations moved up one step, pushing assemblers and country buyers down one.¹

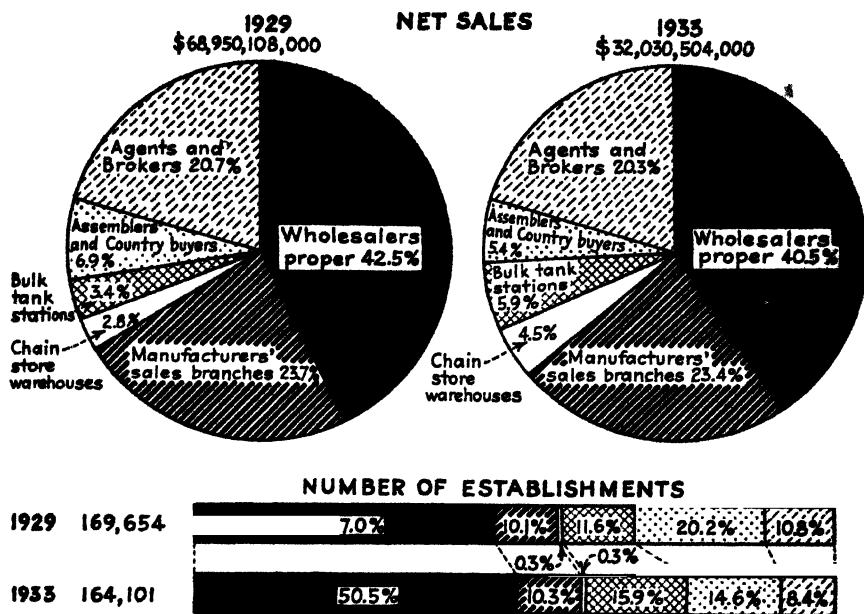


CHART IV.—Wholesale trade, by type of establishment.²

The value of groceries and foods (except farm products), amounting to approximately \$7,526,000,000 or 23.5 per cent of the total wholesale business, was the largest item reported in 1933. The second largest, in dollar value, was farm products used as raw materials. The amount was

¹ The Census officials for the 1933 survey offer the following statement concerning the comparability of the two censuses.

While comparisons with 1929 are extremely useful and significant, the two censuses are not exactly alike, owing largely to differences in the canvass, coverage, and classification. For example, cream stations are included in the figures for 1933 but were not included to any large extent in 1929. On the other hand, establishments with annual sales under \$1,000, or under \$500 in the case of assemblers and country buyers, are not included in the 1933 figures but were included in 1929. These differences naturally affect the number of establishments but do not have much influence on the volume of business.

Owing to lack of commodity information for 1933 the classifications of establishments by kind of business may not have been as accurate as in 1929, thus causing somewhat of a shift in classifications. Furthermore, additional classifications were created for 1933 to cover wholesale distributors of beer, wine, and spirituous liquors. A certain latitude must also be allowed for variations as between kind of business classifications which may have been caused by lack of uniformity in terminology throughout the country.

² Bureau of the Census, U.S. Department of Commerce. Census of American Business, Final U.S. Summary of Wholesale Trade, 1933, Published November, 1934.

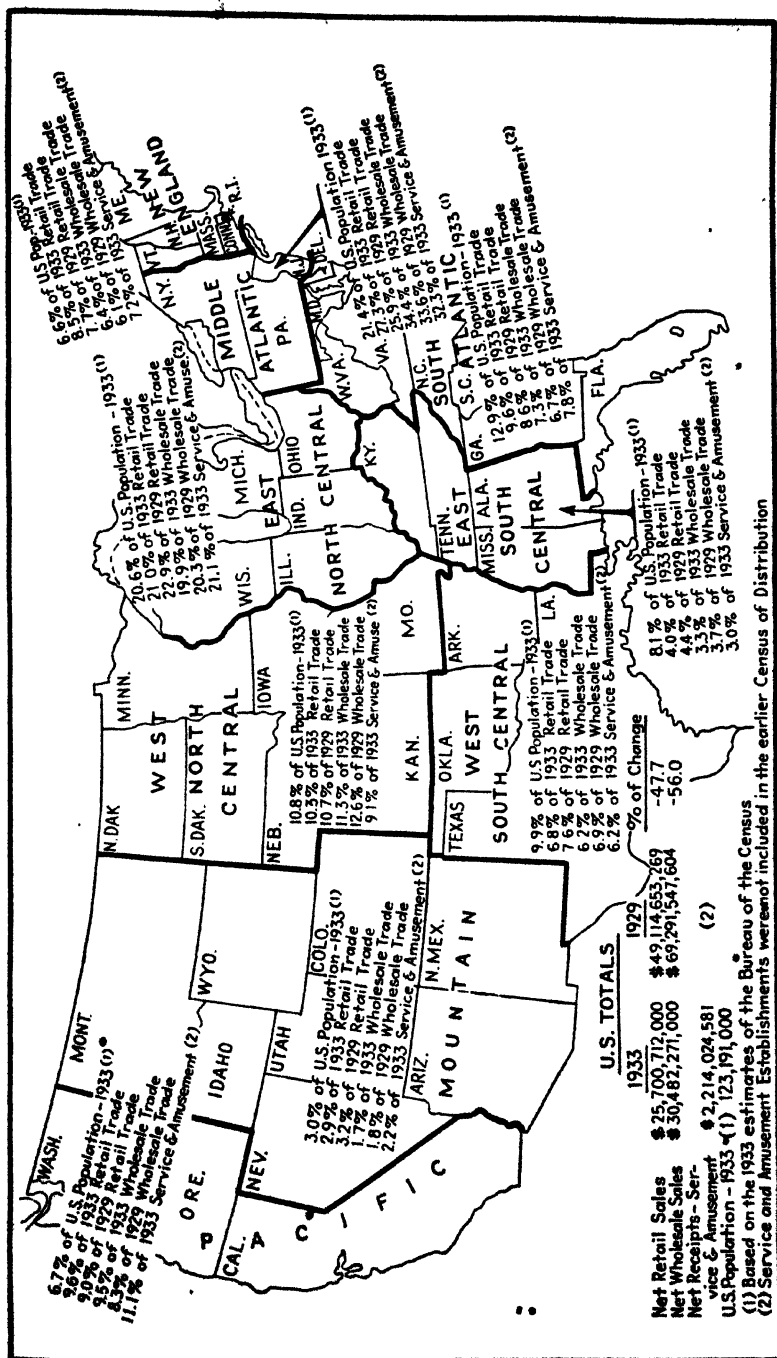
approximately \$3,850,000,000, or 12 per cent of the total. The third in value was farm products used as consumer goods, totaling \$3,161,675,000, or 9.9 per cent of the total. Petroleum and its products were next in rank with a value of almost \$2,290,000,000, or 7.2 per cent of the total. Dry goods was fifth from the top with sales of \$2,242,392,000, or 7 per cent of the total.

The wholesale trade paid out in the form of salaries, wages, and commissions \$1,645,539,000 in 1933 to 1,058,767 men and women. These figures do not include the sums withdrawn by proprietors and firm members.

The 1929 Census reported the volume of wholesalers' business at approximately \$20,000,000,000 more than the volume of retail sales for the same year; the 1933 Census reported the wholesale volume at approximately \$5,000,000,000 more than the retail volume. Why is this? One might naturally think that the retail volume would be higher than the wholesale volume owing to the fact that the retail price for an article of merchandise is considerably higher than its wholesale price. There are several explanations for the higher wholesale value. Among the more important are: (1) Many goods sold at wholesale go directly to industrial, institutional, and other users and never pass through the retailers' hands. It has been estimated, for instance, that almost 45 per cent of manufactured goods goes direct to industry. (2) The wholesale volume includes the sales of brokers, commission men, and other agents as well as wholesale merchants. The sale of a product therefore may be counted several times, thus inflating the final figure. A carload of fruit, for example, might be reported by a country buyer, a wholesale receiver, an auction house, and a fruit jobber, thereby being counted four times.

Geographical Distribution of Wholesale Trade.—The distribution of population, wholesale and retail trade, for 1929 and 1933 and the sales of service and amusement establishments for 1933, by the nine geographical regions, are shown on Map 3. Our attention for the present is confined to the wholesale situation. Approximately 50 per cent of the 1933 wholesale volume is reported by firms located in the four states of New York, Illinois, California, and Pennsylvania. Another group of four states—Ohio, Massachusetts, Missouri, and Texas—adds 17.75 per cent more. Thus these eight states account for approximately two-thirds of the total wholesale trade of the United States. The State of New York secures one dollar out of every four spent in the wholesale trade—or almost \$8,000,000,000 in 1933.

The greatest decreases in wholesale business during the period 1929–1933 occurred among the wholesale functionaries operating in the states depending primarily on the wheat, cotton, and automobile industries.

MAP 3.—Percentage of United States trade in each region.¹

¹ Based on preliminary reports from the 1934 Census of American Business. Published by U. S. Department of Commerce. Domestic Commerce, Sept. 10, 1934.

Classification of Wholesale Functionaries.—Wholesale distributors may be classified on the basis of *ownership of goods* into (1) merchants and (2) all others who do not take title. Classified on the basis of *control* we find independent, chain-store, branch-house, and cooperative wholesale establishments; on the basis of the *number of functions performed* there are full-service and limited-service merchants and the more or less specialized agency group; on the basis of *territory covered* there are domestic and foreign; and national, sectional, and local wholesalers.

Census of American Business Classifications.—The 1933 *Census of American Business* divides the wholesale establishments into six major groups, viz., “wholesalers proper, manufacturers’ sales branches, chain store warehouses, bulk tank stations, assemblers and country buyers, and agents and brokers.”¹ *Wholesalers proper* are the more or less regular wholesalers who take title to the merchandise; i.e., they are wholesale merchants. They are largely independent in ownership and may operate either in domestic or in foreign trade. The group designated *manufacturers’ sales branches* comprises units that are merely parts of the manufacturer’s sales organization used in marketing his output. Some manufacturers do some regular wholesaling when they buy goods from other producers in order to supplement their own line of goods. *Chain-store warehouses* are part of the marketing organization of chain-store systems. These warehouses are maintained to supply merchandise and services to the retail units of the system. They perform such services as “breaking bulk,” delivering, and billing the merchandise. This classification includes wholesale commissaries, prepared-food depots, and distribution centers for bakery chains. *Bulk tank stations* perform wholesale functions in the marketing of gasoline, oil, and other petroleum products. Some are independent, buy in large quantities from the producers, and sell in smaller quantities to retail outlets. These are wholesale merchants. Others are merely part of the marketing organization of the producer who uses them to service his own retail outlets; in many instances they sell to independent wholesalers and retailers as well. *Assemblers and country buyers* collect such farm products as grain, cotton, tobacco, and other farm produce. This classification includes cooperative marketing associations, packers and shippers, cream stations, and elevators—cooperative, independent, and line. The *agent and broker* group comprises such organizations as auction companies, brokers, commission merchants, export and import agents, manufacturers’ agents, selling agents, and other agents.

The Census classification, in the opinion of this writer, is perhaps satisfactory for census purposes, but it fails to provide a satisfactory analysis of the wholesale marketing structure. Confusion results because

¹ Cf. Table 17 (p. 124).

no consistent basis of classification is followed. Thus the group wholesalers proper is based on ownership of merchandise handled. Manufacturers' sales branches and chain-store warehouses are based on ownership of the wholesaling enterprise. These groups obviously perform wholesaling functions; they are, nevertheless, merely divisions of the sales organization of the manufacturer and the chain-store system. The bulk tank station group results from a classification based on the kind of product sold, or, to be more accurate, on the kind of storage container used. Here we find the regular independent wholesale merchant who takes title, buys in large quantities, breaks bulk, sells and delivers to independent retailers, to industrial users, and, in the case of fuel oil, direct to the consumer; and sales branches of manufacturers, which service their own retail outlets and sell direct to industrial users and to the ultimate consumer. These producer-owned wholesale branches usually sell to independent retailers and wholesalers as well as to the company-owned outlets. The classification assemblers and country buyers rests upon still another basis, *i.e.*, the dominating marketing function and the place of its performance. The individuals and firms performing these services may be country retail merchants, independent buyers, or agents representing a manufacturer, wholesaler, packer, or other principal. The last group, agents and brokers, is classified on the basis of the relationship of the functionaries to the ownership of the goods. The members of this class do not take title to the goods; they merely act in behalf of the buyer, the seller, or both.

A Suggested Classification of Wholesale Functionaries.—A classification that is logical and at the same time useful for analytical purposes is here suggested. The student should recall that we are discussing the structure of our marketing organization. Consequently, our emphasis is on the functionary that performs the service rather than on the service itself.

FUNCTIONARIES IN WHOLESALE DISTRIBUTION

I. Independent functionaries:

1. Merchants.

a. Service wholesale merchants.

- (1) Wholesale merchants.
- (2) Exporters.
- (3) Importers.
- (4) Independent bulk tank stations.
- (5) Supply and machinery distributors.

b. Limited line service merchants.

- (1) Cash-and-carry wholesalers.
- (2) Drop shippers or desk jobbers.
- (3) Mail-order wholesalers.
- (4) Wagon wholesalers.

- a. Country buyers and assemblers.
 - (1) Independent milk and cream stations.
 - (2) Independent elevators.
 - (3) Independent packers and shippers.
- 2. Agents.
 - a. Brokers.
 - b. Commission men.
 - c. Factors.
 - d. Resident buyers.
 - e. Manufacturers' agents.
 - f. Selling agents.
 - g. Export agents.
 - h. Import agents.
 - i. Purchasing agents.
 - j. Auctioneers.
 - k. Some country buyers.
 - l. Other agents.
- II. Sponsored functionaries:
 - 1. Cooperative sales organizations—producers, merchants, and consumers.
 - 2. Manufacturers' sales branches.
 - 3. Chain-store warehouses.
 - 4. Producer-and-"chain-store"-owned bulk tank stations.
 - 5. Line elevators.
 - 6. Distributor- and manufacturer-owned milk and cream stations.
- III. Facilitating marketing agencies:
 - 1. Fairs and markets.
 - 2. Auction companies.
 - 3. Commodity and produce exchanges.
 - 4. Stockyard companies.
 - 5. Security exchanges.

Since we are at present primarily interested in the elements of our marketing organization, we can facilitate our analysis by grouping the various marketing agencies and institutions used in wholesale distribution under the three major headings indicated. This arrangement presents a complete picture of the functionaries involved by emphasizing the difference between (1) the independent wholesale merchant who buys on his own account from wide sources in large quantities, breaks bulk, and sells in smaller quantities to widely scattered retailers; (2) the factory sales branch and chain-store warehouse; and (3) the facilitating agencies. Each of the members of division two is part of the sales organization of the parent company. The factory branch is owned and operated by the producer for the purpose of selling his own product. There is no buying of merchandise; some sales branches do not carry stocks of merchandise. They should be regarded as part of the factory sales organization. The chain-store warehouse comes nearer being comparable with the wholesale merchant; yet here we find the warehouse an integral part of the chain's marketing organization. The problems of organization and operation are quite different in each of the three cases. The costs of marketing are

materially affected by the effectiveness with which these problems are solved.

The justification for placing organized exchanges in this list of wholesaling functionaries is that these institutions are constantly becoming more important in the marketing, on a wholesale basis, of an ever-increasing number of commodities. They facilitate financing and risk bearing, promote standardization and grading, aid in the transfer of ownership, and collect and disseminate market news.

Wholesale Merchants.—Wholesale merchants may be divided into those that give a full line of services and those that give only a limited number of services.¹ All have the two common characteristics of possessing ownership of the goods they sell and of being independent business enterprises. This definition excludes chain-store warehouses and factory sales branches.

Relation of Wholesale Merchant to the Retailer.—The wholesaler is of great economic value to the small independent retailer. The major function of the wholesaler, from the retailer's point of view, is that of a buyer. It has been estimated that there are probably more than 9,000 manufacturers of drugs, chemicals, and drug sundries; 11,000 manufacturers of food products; 6,500 manufacturers of hardware and household utensils;² and, of course, several millions of farmers. It is obvious that it would be physically impossible as well as grossly uneconomical for the typical retailer to attempt to supply his varied though small-scale needs by personally contacting this mass of producers. The retailer frequently finds it convenient and economical to buy a large portion of his stock of merchandise from one source. If the typical grocer carries from 2,000 to 3,000 items, and the average retail drug store carries 8,000 to 12,000 different items, it needs little argument to convince one that these retailers could not hope to supply their needs by going direct to the manufacturers. This is especially true because of the fact that the retailer usually buys on credit, in small quantities and wants prompt and frequent deliveries.

The wholesaler acts as a reservoir of merchandise from which the retailer draws at will. He assembles merchandise of great variety in comparatively large quantities. Estimates have been made indicating that the typical wholesale druggist carries from 45,000 to 65,000 items; the dry goods wholesaler, as many as 250,000 different values; the electrical supply jobber, as high as 30,000 items; the hardware wholesaler, 100,000 items; and the wholesale grocer may carry a stock of 20,000 to 30,000 items.³ These figures suggest how the performance of the storage and

¹ *Definitions and Classifications Wholesale Distribution*, p. 20, 1930.

² BECKMAN, T., *Wholesaling*, Chap. II.

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³ *Ibid.*

delivery functions for the retailer have been simplified through the use of the wholesaler. The fact that the retailer can secure prompt deliveries makes it unnecessary for him to carry large inventories. This reduces the amount invested in stock, makes possible a more rapid rate of turnover, and reduces interest charges, rent, insurance, and risks of loss from price and fashion changes.

Other Services Performed by the Wholesaler.—Since the wholesaler buys in large quantities, he frequently performs such functions as sorting and grading, which may be a service to the producer or the retailer or both. This function of grading is especially important in the marketing of poultry, eggs, grain, live stock, and certain other agricultural products. Retailers may, and many do, buy merchandise from the wholesalers on time or credit; i.e., they may be granted ten, twenty, or thirty days in which to pay. They may be able, in the meantime, to sell the merchandise and pay the wholesaler out of the proceeds. If the retailers were forced to pay cash upon delivery, many of them would be forced out of business. Thus it is evident that the wholesaler may, in numerous instances, perform the function of financing. There is little doubt, however, that the practice is carried too far when the wholesaler aids in keeping in existence retailers who are not needed or who are inefficient.

The wholesaler sometimes performs a valuable service in aiding the retailer to sell. His success, in fact, depends upon the success of the retailer. The salesmen of the wholesaler are in a particularly favorable position to offer valuable advice to these dealers. The salesman, traveling from store to store, observes both good and bad sales practice. He can offer valuable suggestions with reference to window displays, store layout and arrangement, demonstration, and salesmanship. Some wholesalers have found it advisable to give assistance in advertising, pricing, stock keeping, credits, and collections, and in installing accounting systems. Since 1927 a number of wholesalers have taken definite steps to aid the retailer in meeting chain-store and mail-order competition.

A study made in the Middle West by a farm publication illustrates the value of the wholesale merchant to the small-town retail merchant.¹ This survey covered the activities of 142 large wholesalers of groceries and showed that from 40 to 90 per cent of the wholesaler's retail business goes to stores in towns with populations less than 10,000. Seventy-four per cent of the wholesale grocers, 84 per cent of the wholesale dry goods merchants, 66 per cent of the wholesale druggists, and 81 per cent of the wholesale hardware dealers did 50 per cent or more of their business in farm trading centers.

¹ *The Farmer's Wife*, St. Paul, Minn. A summary was published in *Sales Management*, p. 558, Dec. 1, 1934.

Classification of Wholesale Merchants.—There are four bases of classification of wholesale merchants which aid us in getting a clear picture of the position of this functionary in our marketing system.

On the basis of the extent of the *line of merchandise* carried there are general and specialty wholesalers. There are general merchandise wholesalers who cater to the needs of the rapidly diminishing old-type general store. These wholesalers carry a general line of dry goods, hardware, and some other lines. With the decline of the rural general store, this type of general wholesaler has found it necessary to adjust himself to the changing order or perish. The other type of general wholesaler confines his activities to the handling of one general line of merchandise, such as dry goods, hardware, drugs, electrical supplies, or groceries. The aim of this type of merchant is to be able to supply practically all the needs of the individual retailer for the particular line of merchandise represented. The specialty wholesaler, on the other hand, tends to emphasize one line of products. Thus there is a tendency for the general hardware wholesaler to disintegrate, his place being taken by dealers who specialize in a very limited line, such as the paint wholesalers. In the grocery field, for instance, are found dealers specializing in coffees and teas, sugar, or flour. It appears that this type of wholesaler was developed to meet the needs of the unit specialty retail store which wanted a more complete stock from which to choose and the needs of certain manufacturers who looked to wholesalers as a source of raw material.

On the basis of the extent of the *territory* served there are national, sectional, and local wholesalers. The descriptive term used not only indicates the extent of territory covered but also suggests the volume of business secured. The national wholesalers tend to confine their activities to specialties and frequently brand and advertise their products. They sometimes do a sectional and a local wholesale business in conjunction with their national selling and, in some instances, even engage in manufacturing.

The local wholesaler typically has lower operating cost than the two other types. He is able to make prompt and frequent deliveries. The business has the advantage of close personal supervision of the management. It appears that, because of these advantages, manufacturers selling a nationally advertised brand and those selling unbranded goods prefer the local wholesalers.

On the basis of *method* used there are orthodox, mail-order, and cash-and-carry wholesalers, sub-jobbers, wagon or truck jobbers, drop shippers, exclusive agencies, and distributing warehouses. The orthodox wholesaler is the typical service dealer who acts primarily as a distributor of producers' and manufacturers' goods and performs the marketing functions which have been discussed in the preceding pages. The sub-jobber

is a small-scale wholesaler serving a small group of patrons. This type of merchant, instead of buying direct from the manufacturers, producers, or importers, usually buys from a large wholesaler. The wagon jobber is a wholesale peddler. By means of trucks the wagon jobber makes regular trips over a designated route, making sales and deliveries simultaneously. The sales are usually made for cash. The merchandise sold by this type of wholesaler is usually nationally advertised. The mail-order wholesaler attempts to make sales to the retailer by means of catalogues and direct-mail solicitation. Butler Brothers has been the outstanding example of this type. When a wholesaler forms a contract with a manufacturer to sell his goods and not to handle any competing lines, he becomes in reality an exclusive agent for that manufacturer.

The term cash-and-carry wholesaler suggests the outstanding feature of this functionary. The competition of the independent retailer with the chain store and the increasing intensity of competition among wholesalers have brought about an attempt to reduce cost through eliminating certain services. The cash-and-carry wholesaler is one manifestation of this condition. This type of dealer usually has a warehouse and carries a rather wide line of merchandise but makes no deliveries and gives no credit.

On the basis of *organization* there are independent, cooperative, manufacturing, semi-jobbing, and chain or "associated" wholesalers. The *independent* wholesaler operates independently and without affiliation with a marketing association or other groups. Such dealers may contract for the entire output of certain manufacturers and may organize independent retailers into associations and groups so as to control their markets more effectively.

The *cooperative wholesale organization* is usually the creation of a group of retailers who are seeking the advantages of quantity buying. Such organizations operate on a low-cost basis because of the small expenditures for sales promotion, credit and collections, and the limited services offered. They may, in fact, become merely purchasing agents for the cooperative retailers; when this happens they cease to be independent wholesalers.

The *manufacturing wholesaler* either owns and operates factories or contracts with factories to produce according to his own specifications. He is thereby able to control the quality, design, and quantity of his merchandise. This type of dealer is quite important in the clothing, confectionery, jewelry, grocery, and drug fields.¹

The *semi-wholesaler* is a dealer who performs the services of both a wholesaler and a retailer. Some retailers desiring to secure quantity discounts found that they must secure a larger volume of sale. As an

¹ BECKMAN, *op. cit.*, pp. 40 ff.

increase in sales to the consumer appeared limited, the merchant sought an outlet for the surplus merchandise among small retailers. The enterprising merchant was thus able to purchase at wholesale prices not only the merchandise sold to the small retailers but also that sold in his own retail store. In other instances, a wholesaler may find that, owing to keen competition, his retail customers are slipping away from him. He may establish retail stores or organize a chain system so as to be sure of a profitable outlet for all of the merchandise he buys.

The *chain wholesaler* is a more recent development. Competition from retail chains, department stores, mail-order houses, and house-to-house selling agencies has cut down the sales of the independent retailer who is the logical customer of the independent and orthodox wholesaler. The business of the wholesaler, naturally, has been greatly affected. Many of the large-scale retailers buy in much larger quantities than the wholesalers; consequently, they secure discounts from manufacturers as large as those received by wholesalers and sometimes larger. This situation is being met by developing an organization comprising outstanding wholesalers handling the same lines of merchandise who are located at strategic points throughout the country. These dealers get the best prices because of their large volume of buying; they may even maintain centralized buying offices in the major markets of the United States and of the world. They secure certain advantages from standardized organization and practice. It is a short step to the establishment of associations of independent retailers and to the performance of manufacturing activities. The associations are organized, sponsored, given special prices and services, and in other ways aided to meet the competition from the large-scale retailers.

The Census of 1929 classified cash-and-carry wholesale merchants, drop shippers, mail-order wholesalers, wagon distributors, and distributing warehouses as limited-function wholesale merchants.¹ These functionaries are sometimes referred to as the "newer types" of wholesalers. They represent attempts of independent wholesale distributors to reduce costs and to meet the competition and to prevent the loss of business that might result from the growth of chain-store systems, department stores, and mail-order houses and other large-scale retailing organizations who go around the regular full-service wholesale merchant direct to the manufacturer. The new-type wholesalers attempt to reduce wholesaling costs through shifting some of the customary services rendered by wholesale merchants either to the producer or to the retailer,

¹ According to the Census there were 2,292 limited-function wholesalers in 1929. There were 2,756 cash-and-carry wholesalers, 583 drop shippers, 41 mail-order wholesalers, 817 wagon distributors, and 95 distributing warehouses. There were 417 wholesaling manufacturers.

providing a more flexible service to meet the new competitive situation, and by reducing the cost of sales promotion.

*Classification of Wholesale Grocers.*¹—The following quotation classifies all wholesale grocers into four major groups on the basis of the functions performed:²

a. The wholesaler who performs functions of warehousing, breaking bulk, shipping or delivery, and credit, and, in addition, travels salesmen.

b. The one who performs functions of warehousing and breaking bulk only, sells for cash only, and requires customers to call for the goods—known as cash-and-carry wholesaler; usually has branches in various strategic points.

c. The "contract" jobber—performs functions of warehousing, breaking bulk, delivery and credit. Additional functions involve instructions of retailers in proper merchandising in all its aspects. Prices competitive with chains or nationally distributed leaders. Provision of full line of private label products and advertising for a group of retailers who are bound to him by contract to buy specified portions of their requirements from the parent house and to follow its merchandising plan.

d. The wholesaler who performs functions of purchasing, warehousing, breaking bulk, and, to some extent, delivery. Merchandising service and credit with retail members who own the wholesale house. *Known as retailer-owned wholesaler.*

Volume of Business Done by Wholesale Merchants.—The wholesalers proper transact approximately 40 to 43 per cent of the wholesale business. This group, comprising 79,654 establishments, enjoyed net sales amounting to \$29,288,220,000 in 1929.³ A larger number by 3.8 per cent had net sales that were 55.8 per cent less in 1933.⁴ These figures give strong evidence that the wholesale merchant enjoys a strong economic position in our wholesale marketing structure. The fact that the number of establishments increased during a period when there was such a drastic decline in sales volume indicates, perhaps, the inherent trade strength of this functionary. It is estimated that approximately 62 per cent of the 1929 volume was sold on credit; that almost \$522,000,000 worth of merchandise was sold by the wholesale establishment directly to the ultimate consumer; and that approximately \$5,660,000,000 was sold directly to industrial concerns.

Table 18 gives the estimated sales volumes of wholesale merchants, by kinds of business, for the census years 1929 and 1933 and rough estimates for 1932 and 1934. The drastic effects of the depression on

¹ Wholesalers proper had net sales of \$3,121,000,000 in groceries and foods in 1933.

² Adapted from American Management Association, *Marketing Executives' Ser.* 68.

³ Dr. L. D. H. Weld estimated, after making adjustments for duplication, that the sales of wholesale merchants to retail merchants in 1929 were approximately \$20,300,000,000. *Printers' Ink Weekly*, May 25, 1933.

⁴ The volume of business for 1934 was estimated at \$14,700,000,000, or an increase of 13.5 per cent over that for 1933.

sales volume are shown clearly by means of the percentages for 1932, 1933, and 1934, based on the peak year 1929. It will be noted that nine kinds of businesses enjoyed sales in excess of one billion dollars in 1929; only three kinds of businesses enjoyed sales of more than a billion dollars in 1932, 1933, and 1934. The kinds of businesses that suffered the greatest decline in sales volume were those selling automotive products, farm products used as raw materials, electrical goods, lumber and building materials, metals, petroleum and its products, plumbing and heating equipment and supplies, and jewelry and optical goods. The ones that suffered least were drugs and drug sundries, amusements and sporting goods, and tobacco and its products (except leaf). The businesses affected most were those dealing in durable goods. The ones that responded most quickly to improved conditions following 1933 were automotive products, electrical goods, and farm products used as consumer goods.

The sale of groceries and food (except farm products) was the largest item for wholesalers proper. The total value in 1933 equaled more than \$3,121,150,000, or 24.08 per cent of the total volume for this functional group. Farm products used as consumer goods was second with a dollar value of almost \$1,590,000,000, or 12.27 per cent; farm products used as raw material, with a value of almost \$1,225,000,000, or 9.45 per cent, was third; dry goods, with a value of \$846,233,000, or 6.53 per cent, and tobacco and its products (except leaf), with a value of \$523,670,000, or 4.04 per cent, were fourth and fifth, respectively.

Volume of Business Transacted by Sponsored Wholesale Outlets.—Since the Census reports give estimates of sales by establishments owned and operated by producers and retail organizations, it is necessary to follow the Census classification in order to get a complete picture of wholesale distribution. Manufacturers' sales branches which carry stocks of merchandise reported sales of \$5,089,489,000 for 1933. Sales branches which did not carry stocks reported sales of \$2,406,737,000. Groceries and food products, except farm products, in the first group amounted to \$1,612,867,000, or 31.7 per cent; tobacco and its products (except leaf) accounted for \$512,474,000, or 10.1 per cent; while machinery, equipment, and supplies, except electrical, provided \$438,249,000, or 8.6 per cent of the group total. The sales of metals, except scrap, accounted for \$719,832,000, or 29.9 per cent of the volume reported by sales branches without stocks; machinery, equipment, and supplies, except electrical, provided a volume of \$249,733,000, or 10.4 per cent; while tobacco and its products (except leaf) reported \$206,727,000, or 8.6 per cent of the total group sales.

The sales of chain-store warehouses amounted to the sum of \$1,431,563,000. Groceries and foods, except farm products, accounted, as

would be expected, for the major portion of chain-store warehouse sales. The total was \$1,172,607,000, or 81.9 per cent. Bulk tank stations experienced the smallest decrease in sales volume, 21.2 per cent, of the

TABLE 18.—ESTIMATED NET SALES OF WHOLESALERS PROPER,¹ BY KINDS OF BUSINESS, 1929, 1932, 1933, AND 1934*

Kind of business	Millions of dollars				Percentage of 1929	Percent change 1934 over 1933
	1929	1932 estimated	1933 actual	1934 estimated	1932/1933 1934	1933
Total.....	29,288	13,479	12,960	14,710		+14
Amusement and sporting goods . . .	173	104	104	110		+ 6
Automotive products.....	1,383	400	438	550		+26
Chemicals.....	413	240	225	252		+12
Clothing and furnishings.....	1,104	500	416	476		+15
Coal.....	679	360	319	350		+10
Drugs and drug sundries.....	522	380	350	405		+16
Dry goods.....	1,714	900	846	985		+16
Electrical goods.....	847	360	276	330		+20
Farm products—raw materials	3,697	1,120	1,225	400		+14
Farm products—consumer goods.....	3,062	1,500	1,590	890		+19
Farm supplies.....	590	275	246	250		+ 2
Furniture and house furnishings . . .	495	210	175	200		+14
General merchandise.....	453	200	175	197		+13
Groceries and foods.....	5,387	3,000	3,121	500		+12
Hardware.....	714	370	342	400		+17
Jewelry and optical goods.	380	130	105	118		+12
Lumber and building materials	1,284	330	279	295		+ 6
Machinery equipment and supplies (except electrical).....	1,188	530	488	540		+11
Metals (except scrap).....	673	195	161	185		+15
Paper and its products.....	704	380	333	382		+15
Petroleum and its products.	724	335	236	270		+14
Plumbing and heating equipment and supplies.....	498	175	143	165		+16
Tobacco and its products (except leaf)	858	540	524	570		+ 9
Waste materials.....	474	285	272	280		+ 3
All other products.....	1,272	660	571	610		+ 7

¹ Wholesalers proper consists of more or less regular wholesalers in domestic and foreign trade who take title to the goods they buy and sell and are largely independent in ownership.

For comparative purposes the 1929 data have been adjusted to changes in classification of a few large establishments.

Figures for 1929 are actual data taken from *Fifteenth Census of the United States Wholesale Distribution* adjusted to changes in classification in *Census of American Business*, 1933. The figures in 1933 are actual data taken from *Census of American Business*. The years 1932 and 1934 are estimates based on trends of currently published statistics.

* Adapted from *Domestic Commerce*, Jan. 30, 1935.

six type groups reported by the Census. The number of establishments in this group actually increased by 33.5 per cent.

Volume of Business Transacted by Country Buyers.—Country buyers are, in the main, independent business men who buy farm products

directly from the producers and then ship these purchases in carload lots to the central markets. These middlemen take title and assume the risks incidental to ownership. There is a distinct difference in the functions performed by this group from those performed by the orthodox wholesale merchant. The latter typically buys in large quantities, breaks bulk, and sells to retailers. The former buys in small quantities, consolidates these into larger lots, and sells to middlemen in the wholesale field and to manufacturers and processors. Some of these country operators are local retailers who buy country produce more or less incidentally in the process of selling their merchandise to the farmers. The country buyer is an important functionary in many sections of the country in aiding farmers to dispose of their fruits, vegetables, grain, cotton, potatoes, live stock, poultry and eggs, butter, milk, and cream. Not all country buyers, however, are independent business men. Some are buyers employed on a salary or commission basis by operators in the central markets or by processors and manufacturers who use the agricultural products as raw materials.

Country buyers and assemblers reported a sales volume in 1933 of \$718,588,000; farm products-raw materials accounted for 48.3 per cent of this amount, while farm products-consumer goods equaled 46.8 per cent. This group of wholesale functionaries suffered the largest percentage decrease in dollar volume, viz., 63 per cent of the 1929 total. The number of establishments in this group decreased 30 per cent. The decline in the number would have been greater if 2,862 cream stations had not been included in this class which were not included in 1929.

Cooperative sales organizations are formed by cooperative associations for the purpose of performing the marketing function. They are, in fact, the sales agents of the groups of producers. The services usually performed are assembling, packing, grading, storing, financing, advertising, and selling. These cooperative sales organizations differ from the brokers and commission men in that they are in reality not independent middlemen but subsidiaries, or branches, of some group or federation of cooperative associations. This type of marketing functionary probably can sell more efficiently than the individual producer. It collects from the individual producers in small lots, forms car-load shipments, thus securing the advantages of low freight rates; it can provide an organization for securing reliable market information and for following or carrying the product through to the central market or to the retailer. Because of the large volume of sales that may be controlled by a cooperative selling organization it is possible to develop new markets and increase sales economically through advertising and other forms of sales promotion. It is a form of market integration and may perform the services usually performed by the local buyer, the wholesaler, and the broker. This type

of market functionary is of considerable importance in selling fruits and vegetables, butter and cheese, eggs, wheat, cotton, and live stock.

Producers' Cooperatives.—In a producers' cooperative association the members are also patrons. The members are the association, and the officers and directors of the association are their agents for the conduct of the joint enterprise. Some associations act simply as agents for the members and do not take title, while other associations take title but otherwise function and account to members as though acting only as agent.¹ Pooling is a frequent practice. This is an averaging plan under which expenses and returns from sales are pooled and apportioned among members on some previously agreed-upon equitable basis.

The cooperative associations among farmers have materially increased the effectiveness with which a number of the marketing functions are performed. Costs have been reduced by increasing the volume of shipment, by better grading, and by securing more timely market news. Interest in and understanding of the problems of marketing have been developed on the part of the members.

The cooperative associations usually sell direct to manufacturers and to large-scale buyers in the central markets. When selling to consumers, the associations may and usually do sell through independent marketing functionaries. The recent development of cooperative organizations in the central markets for live stock, grains, dairy products, cotton, wool, fruits, and vegetables is now making possible a more extensive use of the cooperative plan.

There was a large decline in the sales volume and the number of cooperative marketing associations reported by the Census. The number in 1929 was 4,208 with a sales volume of \$1,458,366,000; in 1933 the number reported was only 2,729 with a sales volume of \$665,682,000. There were 929 cooperatives in 1933 handling farm products—raw materials, and 1,548 handling farm products—consumer goods. The dollar value of the first group was \$252,582,000, and of the second group \$367,846,000. There were 183 cooperative associations handling farm supplies, 14 dealing in groceries and foods, and 55 miscellaneous associations. Some of these associations bought goods for their members as well as sold their products. Some of the products reported as bought were coal, lumber and building materials other than metal, and petroleum and its products.²

The Present Trade Position of the Wholesale Merchant.—The wholesaler has been adversely affected during recent years by manufacturers' increased use of national and local advertising mediums to tell the consumer about the desirable qualities of their merchandise. Improved

¹ HULBERT, L. S., *U.S. Department of Agriculture, Bull. 1106*, p. 4.

² The organization, policies, and practices of agricultural cooperatives are discussed in Chap. XIX.

methods of transportation and communication have made speedier and more frequent deliveries possible. This service has promoted direct selling from the manufacturer to the retailer. The emphasis on thrift gave the chain, department, and mail-order stores a strong appeal. The small-town store, a faithful customer of the wholesaler, has tended to decline in importance, probably owing to the practice of so many of its former customers to motor to the larger cities. The chains and other large-scale retailers have been taking business from the customers of the wholesalers in the larger cities. Consequently, the wholesaler is being put to the acid test as to whether he still has a place in our marketing organization. As long as he can and does perform marketing services more satisfactorily or at a lower cost than other agencies, he will find a profitable place. He will find it necessary to survey the situation carefully. He will frequently find it advisable to reduce the number of lines carried, weed out unprofitable accounts, revise his sales territories, check up carefully on the costs involved in performing the various functions, and give more constructive selling and management service to his retail customers.

The following figures for a period of time unaffected by depression conditions suggest the serious situation in which some classes of wholesalers find themselves. The sales of wholesalers suffered a steady decline during this period, while the estimated volume of retail sales enjoyed a steady and pronounced increase.

TABLE 19.—COMPARATIVE SALES OF WHOLESALERS AND RETAILERS¹

Year	Wholesalers	Retailers
1928	\$21,193,000,000	\$57,867,000,000
1927	21,371,000,000	56,888,000,000
1926	22,721,000,000	54,925,000,000
1925	23,416,000,000	53,487,000,000

¹ King, *op. cit.*, pp. 373, 374.

During the depression period 1929-1933 the volume of business of wholesale merchants declined more than twice as much as that of chain-store warehouses. This indicates that the relative position of the wholesale merchant has become even less favorable since the publication of the data given in the foregoing table. Some of the wholesale merchants in the grocery and food line have been able to protect their business to some extent by organizing independent retailers into cooperative chains. This plan, however, has its limitations, as conditions during 1929-1933 showed. One difficulty of the average independent wholesale merchant is his small volume of business. This one fact tends to weaken his competitive position.

Wholesale Marketing Expenses.—The extreme competitive situation outlined above has centered the attention of farmers, manufacturers, retailers, politicians, college professors, and the general public, as well as the wholesaler, upon the costs of the wholesaler as compared with the costs of other marketing functionaries. A careful study of the costs of performing these services by certain types of wholesalers has been made.¹ Table 20 presents an analysis of the cost data.

TABLE 20.—OPERATING EXPENSES OF SELECTED WHOLESALERS, 1928

Classification of expense	Percentage of sales			
	Electrical	Hardware	Automotive	Drug
Total selling expense.....	5.05	5.83	7.70	4.34
Total warehouse expense....	2.16	3.04	3.16	3.65
Total administrative expense	6.00	4.73	6.46	3.93
Total fixed expense.....	1.93	2.17	2.66	1.98
Total miscellaneous expense.	0.75	0.91	0.78	0.65
Total expense.....	15.89	16.68	20.76	14.55

The figures in this table show that selling and administrative expenses constitute the major elements of the wholesaler's costs. It will also be noted that the item total expense varies considerably among the different wholesalers, ranging from 14.55 per cent of net sales for the drug wholesaler to 20.76 per cent for the automotive jobber. The same study shows that there is a wide variation in the selling costs of various products handled by the same dealer. One of the important factors affecting the costs of selling any particular product or line of products is the size of the unit sale. The smaller the unit sale, generally speaking, the higher the sales cost. The overhead and routine costs are about as much in selling a \$1 order as in making a sale of ten or twenty times that amount. Some of the factors affecting the unit of sales value adversely are given:²

1. Hand-to-mouth buying on the part of the dealer.
2. Solicitation of business from dealers whose annual volume is so low that it precludes the possibility of purchasing in profitable quantities.
3. Too frequent solicitation of dealers' business on part of jobber salesmen.
4. Solicitation of dealers' business by salesmen of too many jobbers.
5. Sales by jobbers of broken-package quantities at standard-package prices.
6. Too small a variation between standard- and broken-package prices.

¹ McNIECE, T. M., "Analysis of Wholesalers' Operating Costs," *Harvard Business Review*, Vol. III, No. 1, pp. 20 ff. This study covered the activities of forty-three jobbers in twenty-seven states during the fall and winter of 1927 and 1928. There were eleven electrical, thirteen hardware, eleven automotive, and eight drug jobbers.

² McNIECE, *op. cit.*, p. 30.

Wholesaling Costs—Census Figures.—Operating-expense ratios for all wholesale trade combined were higher during 1933 than in 1929, rising from 8.9 per cent of net sales in 1929 to 11.5 per cent in 1933. They were also higher in each type group, except for agents and brokers. For wholesalers proper, average operating expenses rose from 11.7 to 15 per cent; manufacturers' sales branches, from 9.8 to 12.5 per cent; bulk tank stations, from 14.3 to 19.8 per cent; chain-store warehouses, from 4.3 to 4.5 per cent; and assemblers and country buyers, from 4.5 to 9.9 per cent. Operating expenses were higher partly because of reduced dollar volume per establishment and partly on account of the lower prices prevailing in 1933 which necessitated handling a larger physical volume per dollar of sales. In the twenty-five kinds of business, salaries varied from 11.4 per cent of net sales in jewelry and optical goods to 2 per cent in tobacco and its products (except leaf). The highest percentage by type group was for bulk tank stations, where 8.1 per cent of net sales was paid in salaries and wages, while the lowest was for agents and brokers, with 1.6 per cent. The largest employers of wage earners were wholesalers proper, comprising 50.5 per cent of all establishments, employing 636,194, or 58.1 per cent of the total wage earners, at a cost of 7.1 per cent of their net sales. The percentages of sales paid in wages for the other three type groups were as follows: manufacturers' sales branches, 5.7 per cent; chain-store warehouses, 2 per cent; and assemblers and country buyers, 4.4 per cent.¹

Table 21 facilitates the comparison of the expenses of the various wholesale establishments according to the major line of products handled.

Careful analysis of the expenses of wholesalers selling similar lines of merchandise shows that their costs vary from firm to firm because of such factors as differences in managerial ability, volume of sales, and location. Changes in general business conditions cause variations in gross margins, expenses, and profits from year to year. There is a decided difference in the selling expenses of the different kinds of wholesalers. The wholesale grocer, for example, has a selling expense but slightly more than half that of the automotive wholesaler, yet the latter has a net profit of more than twice that of the former. One might expect the costs of the functionaries in the same general class to be similar, yet the costs of chain-store warehouses, for example, vary widely.

Agents That Aid in Wholesale Marketing.—The *Census of American Business* lists seven major groups under the heading agents and brokers, viz., brokers, commission merchants, export agents, import agents, manufacturers' agents, selling agents, and a miscellaneous group. The members of this classification specialize in negotiating or in aiding in

¹ *Final United States Summary of Wholesale Trade in 1933*, Bureau of the Census, U.S. Department of Commerce.

negotiating purchases or sales. Two other functionaries that operate in the wholesale field might be added, *viz.*, advertising agencies, which first appeared as space brokers, and public warehouses, which are constantly adding marketing services to their original storage function.

TABLE 21.—EXPENSES OF WHOLESALE ESTABLISHMENTS BY KINDS OF BUSINESS, 1933¹
(Expressed as percentage of net sales)

Kind of business	Manufac- turers' sales branches			Wholesale trading branches	Retail trade	Wholesale trading branches	Retail trade
	Manufac- turers' sales branches	Wholesale trading branches	Retail trade				
Amusement and sporting goods.	21.1	15.1	18.7				
Automotive products.....	23.0	16.3	11.6	5.0			
Chemicals.....	19.2	15.2	13.3				
Clothing and furnishings.....	16.0	12.8	8.8	3.8			
Coal.....	11.3	16.0	7.3				
Drugs and drug sundries.....	17.0	28.7	25.8	3.0			
Dry goods.....	13.8	13.0	4.9	3.1			
Electrical goods.....	22.3	16.5	9.0	13.6			
Farm products—raw materials.....	6.9	5.4	...		6.4	3.6	7.5
Farm products—consumer goods.....	14.8	23.4	11.2	8.0	15.4	13.2	16.4
Farm supplies.....	15.6	16.3	10.6	14.6	10.5	11.8	13.0
Furniture and house furnishings.....	22.5	14.8	9.1	18.6			
General merchandise.....	11.8			11.0			
Groceries and foods.....	12.8	12.6	13.8	4.3	9.7	16.	8.8
Hardware.....	21.4	18.1	5.5	27.8			
Jewelry and optical goods.....	23.8	31.4	10.9				
Lumber and building materials.....	22.7	17.2	10.5				
Machinery, equipment and supplies (except electrical).....	24.9	25.8	8.8				
Metals (except scrap).....	15.8	11.5	3.0				
Paper and its products.....	20.7	16.7	8.1				
Petroleum.....				19.8			
Petroleum and its products.....	16.9	15.8	8.0				
Plumbing and heating equipment and supplies.....	25.2	25.2	17.5				
Tobacco and its products (except leaf).....	6.4	6.5	2.5	5.7			
Waste materials.....	10.8						
All other products.....	17.7	14.7	10.8	0.9	22.1	12.0	

¹ Adapted from *Final United States Summary of Wholesale Trade in 1933*, Bureau of the Census, U.S. Department of Commerce.

The majority of the agent functionaries operate in the large wholesale, central, and terminal markets.

The broker is an agent who negotiates a purchase-sales transaction or brings buyer and seller together in a legal sense so that they may enter into negotiations. This agent, generally speaking, does not take physical

possession of the merchandise.¹ Many producers are not in intimate enough contact with the market to sell their product personally. Large numbers of wholesalers and large-scale retailers do not have the time or the facilities to search out all the possible sources of the merchandise they require. Brokers are in a position to furnish valuable services in such instances. They aid in the marketing of a large variety of services and tangible goods, such as securities, shipping space, newspaper space, personal services, real estate, and various kinds of merchandise.

It is the function of the broker to find buyers for the merchandise of the producers and to locate sources of merchandise for buyers. He fills a gap between buyers and sellers by acting as a representative of one or both in arranging the meeting of the two. The broker serves as a valuable source of market information for buyers and sellers. He must be a good salesman, have a good personality, know many possible buyers and sellers, and be able to secure and hold their confidence.

The importance of the broker in the food industry is clearly stated in the following quotation taken from a speech by W. W. Johnson, president of the National Food Brokers' Association.²

The broker must know accurately market conditions, rail and barge rates, local needs, and even credit conditions, and must keep you posted on them—his is indeed a unique service, and you will find him in every market, providing a system of distribution, devoid of all cost, to the seller until a sale is made, informed, ready for service, willing, eager to please, using his varied knowledge of conditions to serve both seller and buyer and not expecting any compensation if no sale is made. A broker is not only a salesman, but an executive, giving you a sales manager in every market. He is your personal agent. This element of personal contact is a most effective and successful medium of all selling plans, and can never be displaced by any other method.

The manufacturer's agent and the selling agent are special types of brokers. A *manufacturer's agent* generally operates on an extended contractual basis, sells within an exclusive territory, handles non-competing but related lines of goods, and possesses limited authority with regard to prices and terms of sales.³ He is authorized to sell a definite portion of his principal's production. A *selling agent* generally operates on an extended contractual basis, sells the entire output of his principal, and has full authority with regard to prices and terms.⁴

Brokerage Costs.—The brokerage rate depends chiefly upon the type of product, trade custom, and the degree of competition. Brokers

¹ The broker who deals in securities, however, usually has possession, makes deliveries, and frequently arranges for financing the trading.

² Published in the *New York Journal of Commerce*, Nov. 8, 1929.

⁴ Definitions suggested by Committee on Definitions, N.A.M.T.

operating on well-established stock and produce exchanges have standardized published rates. Their costs of operation are low as they need no warehouses, make no deliveries, and assume no credit risk.¹ The average expense of operation of agents and brokers reported by the Census of American Business was 3.2 per cent of net sales for each of the two census years, i.e., 1929 and 1933. There was wide variation in the expenses of brokers. The variation is due primarily to the kinds of goods handled and the amount and quality of services rendered. *Brokers* operating in the automotive-products field reported expenses of 21.1 per cent, while brokers selling drugs and drug sundries reported expenses of only 0.5 per cent. Brokers handling groceries and foods reported expenses of 1.4 per cent. The expenses of *manufacturers' agents* varied from 4.1 per cent for those handling tobacco and its products (except leaf) to 25.5 per cent for agents selling farm products-consumer goods and electrical goods. The figure for farm products is not very significant since there were only four firms in this group; their net sales were only \$157,000. The variation in the expenses of *selling agents* was similar to that found among manufacturers' agents. The expenses of selling agents handling farm products-raw materials was 2.8 per cent; for those handling farm products-consumer goods, the expense was 18.0 per cent. The highest expense for this group was reported by agents selling drugs and drug sundries. The percentage of net sales was 25.2. The highest expense figure reported by any agency group was 45.6 per cent. This figure represented the average expense of eight agents selling jewelry and optical goods.

Commission men are agents who receive and have physical control of the merchandise to be sold. They locate the possible buyers, negotiate the sales transaction, and transfer title of the merchandise without necessarily disclosing the identity of their principal, the true owner. A *commission merchant* transacts business in his own name, takes possession, and negotiates the sale of goods consigned to him by the seller. He usually enjoys broader powers as to prices, methods, and terms of sale than does the broker although he must obey instructions issued by his principal. The commission man collects the sales price, deducts his own commission, pays all expenses, and then remits the remainder to the seller. He receives and may inspect, sort, grade, weigh, measure, store, deliver, and finance the goods as well as perform other necessary and customary services. It will be noted that the commission agent performs many more services than the typical broker. He is not a true merchant because he does not own the title to the merchandise and does not assume the risks of ownership, yet he does transfer title. We have here the unusual situation of a person being able to give that which he does not possess—

¹ It sometimes happens that a broker will give financial assistance to his principal.

the title. He is, however, required to make a detailed report, an accounting, to his principal showing gross receipts and all charges.

The *factor* is a commission merchant who usually advances funds to the consignor. His work consists (1) in financing the operations of the shipper who may be a grower but who is usually a country buyer or merchant; (2) in warehousing or storing the goods; (3) in grading; (4) in selling the goods. Textile factors are specialized commercial bankers performing the function of financing for the textile mills and in some cases combining this function with that of selling.¹

Resident buyers are agents who frequently furnish some of the services, typically performed by both brokers and commission men. The following statement by M. J. Greenebaum indicates the characteristics of this class of marketing functionaries:²

There are two distinct types of resident buyers, one, the commission buyer who receives his compensation from manufacturers, and two, the "paid" buyer supported solely by his retail clients.

The former group is composed chiefly of ex-salesmen. Their business is virtually confined to the smaller retail shops in the apparel field.

The second group classed as "paid" offices may be divided into two or three subdivisions in respect to ownership and patronage. The first classification is that of the solely-owned office which functions for one out of town store or for an ownership-group or chain. The second classification is the co-operative office maintained by a number of independent stores solely for their own needs. The third type of "paid" office consists of those privately maintained for profit. This type exacts an annual fee or "salary" from its clients based on sales volume.

The functions of all three types of "paid" offices are similar and include the furnishing of market and style information, sales promotion service, placing of orders and the follow-up of orders and shipments to insure prompt delivery of the goods as ordered. Some also carry stock of staple goods bought in large quantities to enable the independent to meet other forms of competition.

It has been estimated that purchases amounting to nearly two billion dollars annually are placed or influenced by the paid resident buyer in New York. One such office employs over 200, several others have over 100 on their payrolls. The privately owned offices have as many as 200 clients each.

Commission Costs.—Since the commission agent performs more services than the broker, his commission or fee is generally higher than the broker's. This fee varies for different products and services and may be different in various market centers. The method of remuneration places a premium on volume; consequently, commission men quite often solicit business by telephone, telegraph, mail, and personal representatives. The principal arguments for utilizing the services of a com-

¹ Definition suggested by the Definitions Committee of the N.A.M.T.

² "30-year Old Merchandising Activity Little Known," *Domestic Commerce*, Feb. 10, 1935.

mission agent are superior market connections, which insure the highest available prices, low selling costs, and personal attention given the shipper's goods. According to the 1929 Census 3,479 commission merchants had an average expense of 2.34 per cent. The expenses for 1933 varied from 2.1 per cent of net sales for commission merchants who sold farm products—raw materials to 15.0 per cent for those selling coal.

Advertising Agencies.—The first advertising agencies acted as brokers in selling space in newspapers and magazines. Sometimes they would contract for a certain amount of space in a publication, then sell it in small parcels to various merchants and manufacturers who wished or could be persuaded to advertise. As the publications became stronger, the status of the agency changed. The publishers now pay to the agency a fixed percentage, usually 15 per cent, of the amount spent by the advertiser for space.

The advertising agency has become an essential marketing institution in our mass system of production and distribution. Some agencies specialize in industrial marketing and advertising, while others tend to concentrate on general advertising; a few give their chief attention to mail advertising. A well-established agency has on its staff men and women of wide marketing experience, experts in art, copy writing, domestic science, research, planning, salesmanship, and so on. A client is given the benefit of these facilities. It would not be economical—in fact, it would not be financially possible—for the typical advertiser to supply all these highly specialized services. Competition among the agencies has forced them to give more and more services to the advertiser. They make market surveys, plan sales and advertising campaigns, write copy, prepare or supervise the preparation of the art work and mechanical part connected with the production of the advertising, and check the advertisements being run in the various publications. An agency may, and frequently does, give advice to the advertiser on the basis of its experiences and the results of investigations conducted, concerning the design, quality, size, style, and package of the product, method of selling, and price to be charged.

The advertising agency differs from the broker and commission house in that the services it performs are professional in nature, are more complex, and require a higher degree of education, training, and experience. It receives its remuneration, usually, in the form of a commission paid by the publisher on the basis of the amount of money spent for advertising, while the broker and the commission man are paid out of the proceeds of the sale on the basis of the volume of sale. The advertising agency does not, typically, have anything to do with the physical handling, financing, or buying of the merchandise being sold. It is primarily a functionary

specializing in ways and means for developing demand for a given product or service on a mass basis.

Volume of Business Handled by the Agency Group.—The volume of business handled by the agents reported by the Census is large. The depression of the 1930's struck the group with considerable force. During 1929 the 18,388 agents and brokers reported by the Census transacted business to the amount of \$14,256,695,000. The number in this classification declined in 1933 to 13,816, while the volume of business fell to only \$6,501,254,000. Thus the number declined 24.9 per cent, and the volume of business 54.4 per cent.

The commission men ranked first in the volume of business. They enjoyed slightly more than one-third of the total business for the group in 1933, an amount equal to \$2,223,893,000. The brokers were second with slightly less than one-third of the total volume of business, or \$2,088,770,000. These two functionaries therefore, accounted for approximately two-thirds of the total business transacted by the agent group. The volume of business done by the selling agents fell from \$2,622,633,000 in 1929 to \$988,251,000 in 1933. This group ranked third in volume of sales for the two census years. Manufacturers' agents, the fourth in rank, had sales of \$1,775,355,000 in 1929, but only \$573,964,000 in 1933.

Grocery and food brokers led all brokers with a sales volume of \$1,175,064,000 in 1933. Commission men dealing in farm products—raw materials led all commission merchants with sales of \$1,190,037,000; manufacturers' agents who sold dry goods secured the highest sales volume of this group of agents, with sales of \$114,164,000. The selling agents who sold dry goods likewise led their group of agents with sales of \$384,610,000. Agents selling clothing and furnishings had sales of \$115,743,000.

Facilitating Marketing Institutions.—*Public warehouses* provide storage services which aid in the equalization of supply and demand. They furnish place utility by holding merchandise in locations convenient to wholesalers, retailers, and consumers and may act as agents for merchants and producers. Specialized warehouses are needed for such agricultural products as cotton, tobacco, and the grains. Cold-storage warehouses are needed for perishable goods, such as meat, poultry, dairy products, and fruits.

General merchandise warehouses have become increasingly important with the development of hand-to-mouth buying. They facilitate quick delivery to wholesalers and to retailers. These warehouse companies, in addition to furnishing storage facilities, sometimes break up car-lot shipments and redistribute in the form of l.c.l. lots. Bulk merchandise may be sorted, packed, and labeled in the warehouse and then shipped to

the merchants as ordered. Some companies will "display and sell the merchandise in storage, as agents of the manufacturer-owner."¹

Professor Agnew, in his study of warehouses in the United States, reported five major kinds.² They may, however, be grouped under two general headings, classified on the basis of the availability of their services to the public, as follows.

- I. Private warehouses, such as those owned by farmers, merchants, manufacturers, consumers, and others used for their own private and individual convenience. This group is of no interest to us while we are studying the structure of wholesale distribution, since they do not function as wholesale middlemen.
- II. Public warehouses.
 - A. Warehouses for household goods and furniture. This type furnishes a highly specialized form of service which is indicated by its title.
 - B. Merchandise warehouses. This type is the most important one in the general field of wholesale distribution. It normally furnishes one or more of the following services.
 1. Provides storage facilities which are convenient, economical and safe.
 2. Provides fire protection and insurance.
 3. Provides for car-lot shipments, thereby saving transportation costs.
 4. It helps to reduce loss and damage in shipment by providing car-lot shipment.
 5. It issues receipts both negotiable and non-negotiable which are good collateral.
 6. It makes possible the operation of produce exchanges, where warehouse receipts form the basis of trade.
 7. It supplies trucking service.
 8. It repacks, repackages, remarks, and supplies clerical services in billing out goods to customers of those for whom storage is supplied.
 9. It provides a means of carrying "spot stocks," which expedites the distribution of merchandise.
 10. It provides for a C.O.D. delivery to customers of poor credit rating.
 11. It provides storage in transit. This means that a shipper may send a car over line A, upon which his factory is located to the warehouse at the junction of lines A and B. There it may be stored for any length of time, then forwarded to the buyer over line B and receive the through car rate from factory to buyer. This privilege is usually a concession granted by the railroad company.
 - C. Bonded warehouses. This type of warehouse is carefully supervised by the federal government. Merchandise so stored is placed under bond, and removal is controlled by very strict rules and regulations.
 1. U.S. customs bonded warehouses. These are used by the federal government to facilitate the assessing and collection of import duties. Some of these are owned or leased by the government; others are privately owned.

¹ "Methods of Distribution," National Distribution Conference, *Report of Committee V*, p. 30.

² AGNEW, HUGH E., "Warehouses in the U.S.," *N.A.T.M. Bull.*, November, 1931.

2. U.S. internal revenue warehouses. These are used chiefly for tobacco and liquor. The supervision by the federal government is to insure the payment of taxes.
3. Bonded warehouses licensed by the federal Department of Agriculture. These warehouses are for the handling of agricultural products. They are similar to merchandise warehouses in operation and issue warehouse receipts.
- D. Custodian or field warehouse. This type is a recent development. The manufactured goods or agricultural products are placed under the jurisdiction of a custodian who is held responsible. He issues receipts, "keeps strict accounts, inspects the goods, and defends them against withdrawal, change or other mutation, except upon surrender of the original receipt." This type of service is now largely limited to the regularly established warehousing companies due to the abuses that developed under the less restricted plan followed earlier.¹

The storage rate depends on the characteristic features and qualities of the merchandise stored, its value, and its service requirements. Extra charges are made for such services as handling, weighing, marking, inspecting, coopering, insurance, billing, carting, transporting, and selling.

Facilitating Marketing Institutions.—Organized market places have been used for centuries to aid in the distribution of merchandise. The practice usually followed is for the owner or his representative to offer his merchandise or produce publicly for sale. The buyers generally bid against each other, the one offering the highest price securing the goods.

Fairs and Markets.—The fairs and markets of the Middle Ages were an important part of the marketing structure of that time. Fairs were organized and controlled by kings, powerful members of the nobility, the church, and cities. Much of the merchandise sold at the fairs was imported, although an appreciable amount of domestic goods was bought and sold. The present-day county and state fairs are a continuation, in a somewhat different form, of the old medieval institution. The present-day fair is used primarily as a medium of display, demonstration, and sampling, although some merchandise is sold, usually to consumers, during the fair. As the towns grew, during the Middle Ages, local markets were organized largely for the purpose of selling at retail. The time and method of operation were carefully regulated by the town government or the guilds. Our present-day municipal markets to which near-by farmers and truck gardeners bring their produce are probably an outgrowth of these old markets. Important municipal markets are operated in Harrisburg, Pa., Knoxville, Tenn., and Milwaukee, Wis. The sales transaction in both the fair and the market is a private and

¹ Agnew, *ibid.*

personal negotiation based upon inspection of the merchandise which is present.

The Auction Company.—The auction was developed at an early date. This institution provides a public form of sale as contrasted to the private method at the fair and market, and as practiced by the broker and the commission agents. The auctioneer displays the merchandise and asks for public bids, and the highest bidder secures the goods. These institutions provide limited storage and grading service, advertising through the catalogue, and, in some instances, financial assistance. They usually receive the goods, exhibit samples in the auction room, prepare catalogues listing the products on sale, provide an auctioneer, sell the products to the highest bidder, collect the sales price, pay all expenses including the commission of the auction house, and remit the balance, with a statement of account, to the shipper.

The auction provides a quick way of disposing of large quantities of such raw materials as furs, wool, some agricultural products, and a few manufactured goods in a cash market at *some* price. Important wool auctions are held in London, Liverpool, and Sydney. St. Louis is a center for an important fur auction. The auction is still an important instrumentality in the marketing of these products as well as of many others, such as live stock, fruits, melons, onions, rugs, furniture, and carpets.

Large-scale auctions depend upon a large number of possible buyers and a supply of goods that can be sold on the basis of samples¹ displayed in the auction room. If samples are to be representative, the bulk of merchandise from which they are taken must be graded.

Individual items are often sold by the *auction method* on the basis of inspection, as contrasted to selling through the organized auction house, on the basis of samples. This method of sale is always on a *small scale* and is much used by farmers in selling farming machinery, grain, hay, live stock, and household goods.² Auction companies specializing in the sale of fruits are located in Baltimore, Boston, Buffalo, Chicago, Cincinnati, Cleveland, Detroit, Kansas City, Los Angeles, Minneapolis, New Orleans, New York, Philadelphia, San Francisco, St. Louis, and St. Paul. One of the two Boston auction companies has been in business since 1847; one in Philadelphia was established in 1805.

Auction companies in the majority of cases are owned by wholesalers who deal in the commodities handled by the auctions. One company in Baltimore is reported to be owned by people outside the trade. The fact that auctions are owned and controlled, in so many instances, by dealers interested in buying through auctions has caused many producers

¹ These samples are called "parts of marks" by the trade.

² This method is utilized sometimes to dispose of jewelry, real estate, furniture, and many other articles of merchandise.

to view them with suspicion. A small ring of stockholders has an opportunity, if it wishes to use it, of operating the auction so as to secure special favors at the expense of the shippers. If these marketing institutions are to be of the greatest service to all concerned they should probably be under public regulation, with full publicity given to rates, rebates, and handling charges.¹

Live-stock Exchanges.—These marketing institutions are located in the principal live-stock markets of the country. Their chief functions are to receive, unload, count, weigh, inspect, and feed the animals shipped to the market. The companies provide suitable pens and other facilities, needed to perform the services listed above. The first stockyards were established in Chicago about 1848. Modern stockyards are operated in Chicago, Kansas City, Omaha, St. Paul, East St. Louis, St. Joseph, Indianapolis, East Buffalo, Milwaukee, Sioux City, Fort Worth, Pittsburgh, Jersey City, Oklahoma City, Cincinnati, Baltimore, Pueblo, Ogden, Portland, Seattle, Atlanta, Dallas, Wichita, El Paso, and Jacksonville. By 1921 there were sixty-seven important organized stockyards or markets in the United States.

The primary function of the live-stock market is to provide an outlet or utilization for the live stock. To accomplish this, elaborate machinery has been set up involving many agencies. Stockyard employees, commission men, packers, buyers, traders, speculators, slaughterers, and meat handlers, all have a share in passing the live stock through the market, transforming it into dressed meat, and distributing the meat to the wholesale and retail trade.²

At the central stockyards, commission men sell the live animals to buyers representing local packers, out-of-town packers, feeders, speculators, and others. Most of the commission men conduct private businesses, but farmers' cooperative organizations in a number of instances perform this service, and they now handle a very substantial portion of the business at several markets.³

The central live-stock markets furnish valuable information concerning supply and demand to producers and to buyers. Other important items of market information flow into and out of these live-stock markets. The value of this news depends, to a very considerable extent, upon the use of standard terminology. The importance of this factor is well stated in the following quotation:

Ever since the establishment of central live-stock markets there has been considerable confusion, much disappointment, and untold loss and waste, because of the difficulty in describing market transactions in such a way that the producer

¹ WELD, L. D. H., *The Marketing of Farm Products*, Chap. VII.

² GIBBONS, C. F., *U.S. Department of Agriculture, Bull. 33*.

³ *U.S. Department of Agriculture, Bull. 1440*.

on the farm or out on the range, the slaughterer at some distant packing center, the trader on another market, and the student in his classroom, all would understand exactly what transpired on the market. Practically every live-stock market has its own standards, its individual preferences, and its own methods of doing business. All these matters are thoroughly understood by those who are on the market daily, but when an attempt is made to describe market transactions to someone at a distance, or to someone who is unfamiliar with practices prevailing at that particular market, difficulties are encountered.¹

The stockyard companies are privately owned corporations subject to a considerable amount of supervision by the U.S. Department of Agriculture. The large packers who formerly owned stock in the companies have been ordered to dispose of their stock. The membership list of the Chicago Live-stock Exchange includes commission firms, bankers, and a few live-stock producers and shippers. The exchange, as an organization, does not engage in buying or selling and has nothing to do with the determination of prices.

Shippers usually consign their stock to some commission firm operating in the market where the animals are to be offered for sale.² The stockyard companies unload and yard the stock in pens that have been assigned to the commission house. As soon as the market opens in the morning, prospective buyers begin making the rounds of the pens to inspect the overnight arrivals. When a suitable animal or group of animals is found, private negotiations, on the basis of inspection and shrewd bargaining, are entered into between the prospective purchaser and the representative of the commission firm stationed at that particular pen. The buyer usually makes an offer of so many cents a pound. The seller usually asks more; yet in the great majority of cases an agreement is soon reached; if not, the prospective buyer moves on looking for another suitable lot. He may come back and buy the original lot if he finds none that suits him better or at a lower price, and if the first ones have not been sold in the meantime. When a group has been sold, it is given a lot number by the buyer and sent, by the commission man, to be weighed. The weightmaster issues to the commission firm a certificate giving details as to the number and weight of each animal sold. The commission firm sends a statement to the purchaser showing the same information issued by the weightmaster, plus the price agreed upon and the total amount due. The purchaser approves the statement and returns it with a check for payment to the commission firm. The commission firm usually prepares another statement showing the total receipts of the sale of the individual shipper's animals, together with the freight costs, commission, and other charges. This statement, with a check for the net proceeds, is sent to the shipper as soon as the sales transaction is completed.

¹ U.S. Department of Agriculture, Bull. 1360.

² Many farmers, however, send or truck their live stock direct to the packers.

Commodity exchanges are specialized organized markets which provide a place where their members buy and sell commodities or contracts for future delivery under established rules and regulations. These institutions provide for both "spot" and "future" trading. A spot or cash sale is one made for some specific grade of the commodity to be delivered immediately. Such sales are usually made on the basis of samples displayed on the floor of the exchange. One of the important purposes of an exchange is to make possible trading in contracts for *future delivery*. The sales transactions are on the basis of standardized grades instead of samples.

The commonly recognized functions of commodity exchanges are

. . . to provide a convenient place for the members to meet for the purpose of trading or of exchanging views, to collect and disseminate market information, to establish and enforce rules and regulations designed to facilitate trade, to establish and maintain grades, to provide the machinery for arbitration of trade disputes, and to aid in crystallizing market values.¹

Baer and Woodruff² summarize the economic services of the futures exchanges in the following outline:

1. The insurance function:
 - a. The exchange provides a broad market.
 - b. The exchange provides a continuous market.
 - c. The machinery of the exchange provides a means of offsetting and protecting spot transactions by contra purchases or sales of futures.
2. The financing function:
 - a. A continuous market and the ready transferability of commodities by means of warehouse receipts give the commodity a high degree of liquidity.
 - b. Liquidity of the commodity is an encouragement to larger loans by bankers, and it is a safeguard to the banker.
 - c. Ability to finance commodities readily enables dealers and manufacturers to operate successfully on smaller profit margins.
3. The price-registration function:
 - a. Joinder of markets by wire and cable focuses all price influences on the commodity exchange.
 - b. All future markets are thus linked together and made one broad market.
 - c. The presence of a volume of speculation insures that every known influence bearing upon prices will be given weight.
 - d. Interpretation of news by dealers, manufacturers, and traders assures a degree of anticipation of future events that would not otherwise be possible.
4. The informative function:
 - a. The exchanges gather and make public statistics of supply, transportation, and demand, useful in estimating price changes.
 - b. The daily record of prices informs all interested not only of present prices but of the anticipated future trend.
 - c. On the basis of future quotations, dealers and manufacturers are enabled to make their purchases and sales with a high degree of certainty.

¹ ERDMAN, H. E., *American Produce Markets*, p. 159.

² *Commodity Exchanges*, pp. 211 ff.

5. The regulatory function:

- a. Exchanges regulate speculation and provide for its conduct along orderly lines.
- b. Exchanges' standards of inspection, weighing, and grading contribute to certainty in the trade.

The commodity exchanges furnish a continuous daily market for certain products and provide a public price standard. The members, being highly skilled in forming judgments as to supply, demand, and possible future values, because of their experience and market news-gathering facilities, are in a better position to assume the risks generated by price changes than the individual producers, merchants, or manufacturers. Their experience and operation tend to stabilize prices and to equalize the forces of supply and demand throughout the market area.

There are commodities that, by their inherent nature, by the conditions surrounding their production, and for other reasons, are well adapted to a system of futures trading.¹ The commodity must be homogeneous or capable of grading according to widely accepted standards so it can be traded in by grade without necessity of samples or inspection. It must be relatively non-perishable so that a supply can be stored for future delivery, and there must be a considerable supply of the product. The product should be one for which there is a continuous demand. The supply and demand must be uncertain; if there is certainty as to these factors, prices will be adjusted and stabilized without the need of an organized exchange. Among the large number of products traded in on commodity exchanges are wheat, corn, barley, rye, oats, clover, timothy, rice, alsike, flaxseed, cotton, raw silk, jute, rubber, coffee, sugar, tin, copper, lead, zinc, cottonseed oil, butter, eggs, molasses, pork products, and gasoline and crude oil. The last two were added in 1935.

Important exchanges are located in Chicago, New York, Minneapolis, Duluth, Milwaukee, New Orleans, Toledo, St. Louis, and Kansas City. Some of the more outstanding exchanges are the Chicago Board of Trade, organized in 1848; New York Produce Exchange, established in 1850; St. Louis Merchants' Exchange, organized in 1854; and the Milwaukee Chamber of Commerce, which was officially launched in 1868. The National Raw Silk Exchange, Inc., was opened September 11, 1928; the New York Jute Exchange has been opened since; the New York Rubber Exchange was opened in 1926; the Chicago Mercantile Exchange was organized in 1920 for the purpose of furnishing facilities for the trading of butter and eggs. Important exchanges are found in Liverpool, London, and Winnipeg.

¹ Jones, F. W., *Trading in Raw Silk Futures*, p. 1, a pamphlet published by the *New York Journal of Commerce*.

Membership.—The typical commodity exchange is organized as a corporation. The members elect a president, vice president, other necessary officers, and a board of directors. The size of the membership is usually controlled by limiting it to a definite number at any one time or by maintaining an initiation fee in excess of the market value of the membership stock.

The requirements for membership in the National Raw Silk Exchange, Inc., furnish a typical illustration of membership qualifications. The candidate must be of good moral character, of sound financial responsibility, and be endorsed by two members of the exchange. His name must be posted on the bulletin board for some time before action is taken by the membership committee. The newly elected member must subscribe to the by-laws and rules and all subsequent rules and by-laws. A new member usually obtains his seat by paying the market price.

Members of an exchange are charged dues sufficient to pay operating expenses.¹ The membership of a commodity exchange usually comprises merchants, manufacturers, brokers, commission houses, and farmers' cooperative associations.

No one is allowed on the floor of an exchange, in the capacity of a trader, unless he is a member. Some members seldom, if ever, go on the floor, preferring to do their trading through other members. The trading members are of two major groups: ring brokers, who execute orders for other members and for outside brokers and commission men; the other members, so-called floor speculators, trade on their own account.

The volume of trading on all commodity exchanges has been greatly reduced since 1929. This is due to lower prices, more stringent governmental control, and the general disappointment of the public resulting from large losses suffered during the period 1929–1933. More than 15,428,000 bags of coffee were sold on the New York Coffee and Sugar Exchange in 1929; the number fell to less than 4,232,000 bags in 1932. More than 12,700,000 tons of sugar were sold on the Exchange in 1929; the volume fell to 5,520,600 tons in 1932.

Security exchanges are market places where securities that have been listed thereon may be bought and sold for either investment or speculation. These organizations are voluntary, unincorporated associations, limited in membership. The individuals holding memberships are the only ones allowed on the floor of the exchange in the capacity of a trader. Probably not more than two-thirds of the membership of the New York Stock Exchange are active brokers and traders; many outstanding capitalists hold seats merely for the purpose of securing the reduced commission charges which the rules provide between members. The exchange as an organization does no trading; its function is to provide

¹ BARR and WOODRUFF, *op. cit.*, Chap. II.

trading and other essential facilities to members, regulate their conduct, "maintain high standards of commercial honor and integrity among its members, and to promote and inculcate just and equitable principles of trade and business."

Important world stock exchanges are located in London, Paris—called the Paris Bourse—Amsterdam, Berlin, Tokio, and New York. Stock exchanges of minor importance exist in most of our major commercial and industrial cities. The leading security exchange in the United States is located in New York. The colossal nature of this marketing institution is suggested by the following facts: The average annual sales of stock on this exchange during the decade 1899–1909 were 106,500,000 shares. During the summer of 1919 as many as 2,000,000 shares were traded in a day. This record did not last long. More than 15,000,000 shares changed hands ten years later, during the memorable record day in the autumn of 1929. The market value of 1,127,682,468 shares of securities listed on the exchange January 1, 1930, was \$64,707,878,131; on January 1, 1935, approximately 1,305,420,000 shares had a market value of only \$33,933,882,614; on this latter date 1,187 individual stock issues and 1,540 individual bond issues were listed on the New York Stock Exchange.¹

A member of the New York Stock Exchange secures his membership by purchasing a seat from a present owner at a mutually agreed upon price;² in addition, he must pay an initiation fee of \$4,000, the regular yearly dues, and be accepted by the membership committee—i.e., he must be a citizen of the United States, be at least twenty-one years of age, and be acceptable, as to character, to the committee.

Economic Services of the Security Exchange.—The security exchange performs some very important economic functions. It provides a continuous market for listed securities. Thus anyone having money to invest can always find securities available; one possessing listed securities can always dispose of his holdings and thereby secure cash. The exchange serves as a collector and a dispenser of valuable market news and as a source of information about the firms whose securities are listed. The day-to-day, even hour-to-hour, trading furnishes a measuring stick as to the current valuation of any given security. The exchange provides a valuable vehicle for distributing the available capital of the country among the various industries. When some industries are in a depressed condition, the prices of their securities fall. This is a warning to possible investors to investigate carefully the future prospects of such industries

¹ *New York Stock Exchange Yearbook* 1934.

² A seat on the exchange sold for \$625,000 in 1929; one sold for \$425,000 in December, 1929, only a few weeks after the panic, but by April, 1935, the price had declined to \$65,000, the low since 1919; this price had risen materially by the beginning of 1936.

before placing their funds in the securities of these enterprises. The stock exchange plays an important part in the marketing of securities of new and untried industries—securities of businesses which the conservative investing public would not buy. Speculators buy such securities, partly on borrowed funds, and hold them until the business reaches a stable condition, when investors are willing to put in their savings.

The stock exchange, as is indicated by the foregoing statement, is an important instrumentality for the use of the individual speculator, investor, corporation, and banker. It is of service to governments in marketing their securities and to the consumer in making possible large-scale production and marketing with resulting reduced costs of operation and prices.

Owing to tremendous losses incurred during the period 1929–1933, from speculation on the Stock Exchange, a great popular wave of resentment arose against “Wall Street.” A demand for strict control of the exchanges and of the issuance of corporate securities developed. The Securities Exchange Act of 1934 resulted. This law provides for certain needed regulations governing the issuance of securities and the operations of brokers and investment bankers.

Organized exchanges have certain common characteristics. They are non-profit associations organized to provide certain facilities for their members who engage in trading activities. The exchange itself does no trading and, of course, does not determine prices. These organizations are designated by several different names, *e.g.*, exchange, board of trade, chamber of commerce, and bourse.

The location of a commodity exchange is determined by several conditions, such as proximity to sources of the product, sources of demand, and large and stable money markets. There must be a sufficient volume of trading to make the organization of an exchange feasible; there must be a suitable product in sufficient quantities with a fairly constant large-scale demand.

Summary.—The term wholesale distribution comprises all those marketing activities necessary to effectively market goods from the producer to the retailer, industry, and institutions—in fact, to all buyers, except the ultimate consumers who normally buy from retail outlets. The characteristic functionaries operating in this field are wholesale merchants of various kinds and a large variety of agencies. The former group take title to the merchandise handled and perform several, if not all, of the marketing functions. The latter group aid in negotiating the purchase and sale of merchandise, produce, securities, and services; they do not take title to, and in some instances do not have physical possession of, the goods. Divisions of the sales organizations of some producers and of some of the large-scale retailers perform wholesaling

activities. There is some doubt as to whether these divisions should be regarded as part of the wholesale marketing structure. The performance of wholesale trade in a number of lines of goods is greatly facilitated through the use of such institutions as produce and commodity exchanges, security exchanges, auction houses, public warehouses, and stockyards.

The expenses of wholesale distributors vary widely. This is due to several causes, the more important of which are the kind, amount, and quality of services rendered and the amount of risk involved from physical deterioration and from price changes.

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Questions for Discussion

1. What is the distinction between wholesale and retail functionaries?
2. "Middlemen are, then, individuals, firms, or corporations that stand between prime producers and ultimate consumers and receive a profit for the risks they assume in addition to being paid for the cost of their services." Does this include organized exchanges and salesmen? Why? What are the two major classes of middlemen? What are the sub-classes in each major group? Characterize each as to (a) functions performed, (b) methods of operation, (c) relation to goods handled.
3. What are the chief types of middlemen found in the foreign-trade field? How do their services differ from those performed in the domestic marketing process?

4. "The great service of middlemen to most manufacturers is the effort they devote to selling goods." What other services do they frequently perform?

5. "The only satisfactory explanation of the wholesaler's strength in our marketing system lies in the nature of his services in the distribution of merchandise and in the economies thus effected." What is the nature of his services to (a) the retailer, (b) the manufacturer?

6. "In some trades there is a distinction between the wholesaler and the jobber." In what trades? What is the distinction?

7. "The middlemen operating in city wholesale markets must be located in close proximity to each other, particularly when they appeal to the same class of trade." Why is this true?

8. "Within the past decade, new types of wholesalers have made their appearance, seriously threatening the existence of the older establishments." What is the nature of these? Why have they grown up?

9. The *Census of Distribution* for 1929 reported wholesale sales at approximately \$69,000,000,000 and retail sales somewhat less than \$50,000,000,000. The *Census of American Business* for 1933 reported wholesale sales at approximately \$32,000,000,000 and retail sales at approximately \$25,000,000,000. How do you account for wholesale trade being in excess of retail sales for each period?

10. "Whereas the commission man receives goods from the manufacturer and sells them in his own name, then collects the proceeds, and after deducting his expenses and his commission remits what is left to his principal, the manufacturer's sales agent operates within more narrow limits." What is the difference in services performed and general status of the commission house and the sales agent?

11. "The term 'broker' is usually applied to that class of middlemen who make it their main business to bring buyer and seller together." When and why are brokers used? What are the functions of a stock broker? Of a produce broker?

12. How do sales at auction differ from other forms of sale? When and by whom is this method most frequently, or normally, used? What practices of auction companies are objected to?

13. "A commodity is not suitable for large-scale and smoothly organized competitive trading unless it is by its nature homogeneous or is *artificially standardized* by careful and *authoritative grading*, so that it can be traded in by name without necessity of samples or bulk inspection." Cite a number of commodities which meet these specifications. What other conditions are necessary for futures trading? Why are steel, brass, coal, and lumber not traded in on organized exchanges?

14. What are the expressed purposes of the New York Produce Exchange?

15. What are the proper and professed functions of a cotton exchange?

16. "The usefulness of the produce exchanges and the desirability of their operations have been the subject of a bitter controversy." What have been the chief points in controversy? What services do the organized exchanges perform? How are prices determined on an organized exchange?

17. "Besides the shipping and receiving markets there are two subordinate types that are of sufficient importance to warrant special consideration," *viz.*, auctions and so-called farmers' markets. What are the distinguishing characteristics of each? Who operates in each market?

18. "The making of a successful municipal market with maximum results necessitates virile energetic thought and supervision." What are the essentials of a successful municipal market?

19. Compare and contrast commodity exchanges with auctions; with municipal markets; with stockyards; with a stock exchange.

Assignment

1. Problem 2, p. 124. Busby-Durant Company—Wholesalers' Functions.
2. Problem 1, p. 120. Clermont Company—Wholesale Trade.
3. Problem 1, p. 238. The Big Meat Packers—Wholesale Distribution.
4. Problem 3, p. 217. M. Farnsworth & Company—Specialty Wholesaler.
5. Problem 2, p. 115. Boston Produce Market.
6. Problem 2, p. 259. Blackstone Company—Warehouse Distributor.

CHAPTER VI

THE ELEMENTS OF OUR MARKETING ORGANIZATION— RETAIL FUNCTIONARIES

Purpose of this chapter: To indicate the economic position of the retailer in our marketing structure; to examine the characteristic features of the independent retailer, the department store, the mail-order (catalogue) house, consumer cooperative stores, the utility-owned store, and the company commissary; to compare and contrast, in a general way, the operating methods of each kind of retailer.

Retail distribution comprises those activities necessary to market goods and services to the ultimate consumer. This marketing process may be performed by a producer or a merchant. In practice, however, the major portion of retail distribution is performed by a certain kind of merchant known as a retailer. This marketing functionary has been defined as follows: "Retailer—A middleman who sells to the ultimate consumer. He sometimes sells to institutions, but the bulk of his sales is made to individual consumers. He usually sells in small quantities."¹

The Trade Position of the Retailer.—The retailer occupies an important and strategic position in our general marketing organization. He assumes the responsibility of providing *an adequate stock* of merchandise from which the consumer makes his selections. It is obvious that the consumer cannot satisfy his needs and wants by going directly to the thousands of different and widely scattered sources of supply of merchandise and services. Ordinarily the retailer is expected to provide a *place* to which the prospective customer may come and in which the merchandise is stored, displayed, and demonstrated. His clients may look to him for a number of different forms of service, *e.g.*, delivery, credit, alteration, and repair services. He is expected to supply merchandise and services in the amounts and qualities that meet the needs and wishes of his community or the class of people to whom he caters and at prices his clientele is willing and able to pay. His reputation in the community depends upon his honesty, fair dealings, civic activity, and business ability. The retailer, in order to secure and keep the confidence and patronage of the public, must perform the buying, selling, and other services in a satisfactory and efficient manner. One of the explanations for the recent development of the various "newer types" of retailers is the failure of some of the old-line merchants to live up to

¹ Recommendation of Definitions Committee, N.A.M.T.

their responsibilities. Competition is so keen in the retail field that only those merchants who operate at low cost and with a high degree of efficiency can hope to succeed.

The retailer, from the viewpoint of the producer, manufacturer, and wholesaler, is a specialist in selling. While a number of manufacturers find it advisable to sell through the wholesaler, there are many others who find it economical or otherwise desirable to sell direct to retailers. The farmer sells a large quantity of his produce directly to local merchants, and, of course, the wholesaler typically sells through the retailer. The retailer, in all these instances, furnishes access to a selected market and provides such marketing facilities as a sales place, sales people, advertising, storage, financing, and many incidental business services.

Originally the retailer was an independent merchant who ascertained the needs of his community and then attempted to find and purchase merchandise that would meet these needs. He was, in fact, the "purchasing agent" for the consumer. With the development of mass production the manufacturer began to brand his goods and to advertise them locally and nationally. His purpose was to "create consumer demand" for his particular brand of merchandise. This situation tended to transform the independent retail merchant into a mere distributor of the manufacturer's goods. The coming of the large-scale retail units in the form of chains, department stores, and mail-order houses has changed conditions somewhat. There is a strong tendency toward integration of retailers, wholesalers, and manufacturers, with the large-scale retailers dominating the situation.

Classification of Retailers.—Our analysis and discussion of the elements of retail marketing are facilitated by a classification of the functionaries that operate in this field. Retailers may be grouped into four distinct classes. These divisions result from classifications on the bases of (1) organization and type of operation; (2) control and ownership; (3) kind of business; and (4) method of selling used. Retailers, classified on the basis of organization and type of operation, are as follows:¹

1. Independent.
2. Chain.
3. Mail order.
4. Direct sellers.
5. Commissaries.
6. Utility operated.
7. Other types.²

¹ This is one of the classifications used by the U.S. Census.

² This group includes market and roadside stands, itinerant vendors, leased departments, cooperatives, and a small group of unclassified retail outlets.

Under the heading control and ownership, there are

1. Independent retailers.
2. Corporate-owned and operated retailers.
 - a. Chain stores.
 - b. Branch stores.
 - c. Manufacturers' and wholesalers' stores.
 - d. Utility-owned stores.
 - e. Commissary stores.
 - f. Mail-order stores (catalogue).
3. Cooperative-owned, operated, or sponsored stores.
 - a. Consumer cooperative retail stores.
 - b. Voluntary chains.
 - (1) Sponsored by retailers.
 - (2) Sponsored by wholesalers.

Retail stores classified on the basis of kind of business or major line of merchandise sold produce the following list, according to the Census:

1. Department stores.
2. Variety stores.
3. Men's stores.
4. Family clothing stores.
5. Women's apparel stores.
6. Shoe stores.
7. Furniture stores.
8. Household-appliance stores.
9. Radio stores.
10. Grocery stores (no meats).
11. Combination (groceries, meats).
12. Restaurants, etc.
13. Cigar stores, stands.
14. Motor-vehicle dealers.
15. Filling stations.
16. Drug stores.
17. Hardware stores.
18. Jewelry stores.
19. All other stores.

We should, logically, add to this list retailers of services such as hotels, theaters, barber shops, and many others.¹

Retailers, classified on the basis of the method of selling used, fall into three major groups.

1. Over-the-counter retailers.
 - a. Full-service retailers.
 - b. Self-service.
 - c. Cash and carry.
2. Mail-order retailers (catalogue).
3. House-to-house sellers.

¹ The service retailers were covered by a separate census in the 1933 survey.

We shall pass over without comment the classifications presented above and construct a classification on a multiple basis, *i.e.*, on the basis of organization and type of operation and kind of goods sold. We believe this method of classification is more useful for our purposes. The proposed classification follows.¹

1. Independent retailers.
 - a. Department stores (not members of a chain, nor owned by mail-order houses).
 - b. General stores.
 - c. Limited-line stores.
 - (1) Variety 5-and-10 and to-a-dollar stores (not members of a chain).
 - (2) Men's and boys' clothing and furnishing stores.
 - (3) Family clothing stores.
 - (4) Women's ready-to-wear specialty stores.
 - (5) Shoe stores.
 - (6) Furniture stores.
 - (7) Household-appliance stores.
 - (8) Radio stores.
 - (9) Grocery stores without meat.
 - (10) Combination stores.
 - (11) Restaurants and eating places.
 - (12) Cigar stands and stores.
 - (13) Motor vehicle stores.
 - (14) Filling stations.
 - (15) Drug stores.
 - (16) Hardware stores.
 - (17) Jewelry stores.
 - d. Service stores and establishments.
 - e. All other retail outlets owned and operated independently.
2. Chain-store retailers.
 - a. Department stores.
 - b. General stores.
 - c. Limited-line stores.
 - (1) Variety 5-and-10, and to-a-dollar stores.
 - (2) Men's and boys' clothing and furnishing stores.
 - (3) Family clothing stores.
 - (4) Women's ready-to-wear specialty stores.
 - (5) Shoe stores.
 - (6) Furniture stores.
 - (7) Household-appliance stores.
 - (8) Radio stores.
 - (9) Grocery stores.
 - (10) Combination stores.
 - (11) Restaurants and eating places.
 - (12) Cigar stores.

¹ The different classifications of the Census have been used as much as seems feasible. The sub-classifications are not all-inclusive, as several kinds of stores—*e.g.*, candy and confectionery, dairy products, and dry goods stores, coal and wood yards, news stands, and accessory stores of various kinds—have been omitted. The list as given should be regarded as an illustration.

- (13) Motor vehicle stores.
- (14) Filling stations.
- (15) Drug stores.
- (16) Hardware stores.
- (17) Jewelry stores.
- d. Service stores.
- e. Cooperative stores.
 - (1) Owned by groups of wholesalers or retailers.
 - (2) Owned by groups of consumers.
- f. All other chain retail outlets.
- 3. Mail-order retailers.
 - a. Department stores.
 - b. Catalogue only.
 - (1) General line of merchandise—farm implements, etc.
 - (2) Limited line—mail-order merchants who specialize in selling:
 - (a) Women's dresses.
 - (b) Men's and boys' clothing and furnishings.
 - (c) Shoes.
 - (d) Drugs.
- 4. Commissaries or company stores (maintained primarily for the convenience of company employees).
 - a. Department stores.
 - b. Grocery stores.
 - c. Combination stores.
- 5. Direct selling retailers (house-to-house) who specialize in:
 - a. Men's and boys' clothing and furnishings.
 - b. Family clothing (men's, boys', and children's).
 - c. Women's ready-to-wear.
 - d. Shoes.
 - e. Furniture.
 - f. Household appliances.
 - g. Radios.
 - h. Groceries.
 - i. Drugs and medicines.
- 6. Utility-operated stores.
 - a. Household appliances.
 - b. Grocery.
 - c. Combination.
- 7. Service retailers.¹
 - a. Personal services.
 - (1) Barber shops.
 - (2) Beauty parlors.
 - (3) Funeral directors.
 - (4) Cleaning, dyeing, and pressing.
 - b. Repair shops.
 - c. Theaters.
 - d. Hotels.
 - e. Miscellaneous service retailers.

¹ The 1933 *Census of Service Establishments, Places of Amusement, and Hotels* is not confined to retailers of these services. The group designated *business services* includes a number of establishments that sell to other business firms as well as to consumers.

We have used the six major classifications, based on the type of operation, used by the Census. To this we have added retailers of services. The sub-classifications are based on the type of organization, as in the case of department and general retail stores, and on the kind of goods carried. Thus the group designated *limited-line* retail stores comprises those stores that handle an assortment of one line or several closely related lines of merchandise. A specialty store is a limited-line store that sells specialty merchandise. The names of the other sub-classes are descriptive; consequently, each title will suggest to the reader the nature of the kind of store designated. A variety store is one that carries a wide assortment of convenience, shopping, and, occasionally, specialty goods, all of low unit value. A department store is a retail store which has departmentized both its selling and non-selling functions in order to secure more effective administrative and executive control over the buying, selling, personnel, service, and financial activities. The typical department store carries women's ready-to-wear and accessories, yard goods, men's and boys' wear, furniture and home furnishings, recreational goods, electrical appliances, novelties, notions, and small wares.¹ The country general store carries a wide line of merchandise which may include, in addition to clothing, furniture, and foods, such items as farm implements, feed, coal, and oil products. The store, however, is not departmentized.² A consumers' cooperative store is a retail establishment owned and managed by an associated group of consumers for their own mutual benefit. This type of store represents the consumer's attempt to supply his needs with a smaller expenditure of money through a reduction in retail costs.

The Sales Volume of Retail Stores.—The importance of the retailer in our economic life is indicated by the size of his payroll, the number of his employees and their average earnings, the number of stores, and the annual volume of sales. The total retail payroll for 1929 was almost \$5,190,000,000; owing to the depression this figure declined 43.9 per cent for 1933, or to slightly less than \$3,000,000,000. The number of full-time employees was 3,833,581 in 1929; there was a decline of 29.5 per cent, to 2,703,325, in 1933. The number of part-time employees, however, increased 28.3 per cent. There were in addition 1,510,607 proprietors actually engaged in their stores but not on the payroll in 1929. The number increased 4.2 per cent in 1933. The average annual earnings for each full-time employee were \$1,312 in 1929; the average was \$986, or a decline of 24.9 per cent, in 1933. There were 1,543,158

¹ These definitions follow, to some extent, those recommended by the Definitions Committee of the N.A.M.T.

² When the annual sales of a general store amount to \$100,000, the *Census of American Business* arbitrarily classifies it as a department store.

retail establishments in 1929; the number declined only 1.1 per cent, to 1,526,119, in 1933. The sales volume, on the other hand, declined 49 per cent, or from \$49,114,653,000 in 1929 to \$25,037,225,000 in 1933.

Table 22 presents the sales of retailers by kinds of businesses for the indicated years. The data for 1929 and 1933 are Census figures; those for 1932 and 1934 are Department of Commerce estimates. The retail sales for 1934, it will be noted, were estimated at 14 per cent above those for 1933.

TABLE 22.—ESTIMATED TOTAL NET SALES OF RETAILERS, BY KINDS OF BUSINESS, 1929, 1932, 1933, 1934*
(Millions of dollars)

Kind of business	1929, actual	1932, esti- mated	1933, actual	1934, esti- mated	1934, per cent of total sales	Per cent of 1929 sales		
						1932, esti- mated	1933, actual	1934, esti- mated
Total.....	49,115	25,597	25,037	28,548	100.0	52	51	58
Food group.....	10,837	7,261	6,793	7,269	25.5	67	63	67
Restaurants and eating places.....	2,125	1,636	1,430	1,687	5.9	77	67	79
Farmers' supply—country general stores.....	3,690	1,218	1,561	1,842	6.5	33	42	50
Department, dry goods, and other general merchandise stores.....	5,093	3,208	2,993	3,352	11.7	63	59	66
Mail order, catalogue only.....	447	201	220	275	1.0	45	49	62
Variety stores.....	904	660	678	742	2.6	73	75	82
Apparel group.....	4,241	2,331	1,923	2,269	7.9	55	45	54
Automotive group.....	9,616	3,843	4,419	5,391	18.9	40	46	56
Furniture and household group.....	2,755	895	959	1,132	4.0	32	35	41
Lumber, building, and hardware group.....	3,846	1,380	1,343	1,544	5.4	36	35	40
Cigar stores.....	410	225	190	209	0.7	55	46	51
Drug stores.....	1,690	1,182	1,066	1,173	4.1	70	63	69
Jewelry stores.....	536	188	175	201	0.7	35	33	38
Second-hand stores.....	148	112	105	115	0.4	76	71	78
Other retail stores.....	2,777	1,248	1,182	1,347	4.7	45	43	49

* Domestic Commerce, Feb. 2, 1935.

1929 figures are actual data taken from the *Census of Retail Distribution*. 1933 figures are actual data taken from the *1933 Census of American Business*. The years 1932 and 1934 are estimates based on trends of currently published statistics.

The reported sales of retailers declined less in dollar value from 1929 to 1933 than the reported sales of wholesalers. The retail dollar volume declined 49.0 per cent during the period compared with 55.8 per cent decline suffered by wholesalers proper and 53.6 per cent for all wholesale establishments. Although there was only a slight decline in the total number of retailers, there was, nevertheless, a drastic reduction in the number of those in business in 1929. Those retailers going out of business were replaced by newcomers. Decreasing employment during the period

1931-1934 caused large numbers of people with little or no retail experience, but with a small amount of savings in the bank or having the ability to borrow, to open retail stores. The results were generally quite disastrous, yet the high rate of replacement apparently continued to maintain the number at approximately the 1929 figure.¹

The retail groups that lost the greatest percentage of sales were furniture and household-appliance stores, whose sales in 1932 were only 32 per cent of those enjoyed in 1929;² jewelry stores, whose sales in 1933 were 33 per cent of the 1929 volumes; farmers' supply and country general stores, whose 1932 sales were only 33 per cent of the 1929 sales; and the lumber, building, and hardware group with a low point in 1933 of 35 per cent of the 1929 sales. Variety stores, restaurants and eating places,³ and second-hand stores, on the other hand, were least affected by the depression. The declines in dollar volume were 27, 33, and 29 per cent, respectively, of the 1929 sales. Gasoline filling stations, garages, and tire and battery stores enjoyed a more even sales volume during the period than the retailers selling new automobiles. The number of garages, repair shops, and filling stations actually increased during the period although the dollar volume of sales decreased. The volume of sales of automotive retailers now ranks second only to that of the food retailers. The sales of the first were relatively insignificant no longer ago than 1914. The student of marketing will immediately recognize the fact that the retailers who suffered the greatest decline in sales were those handling durable, luxury, and semi-luxury consumer goods. Those that suffered least were the ones selling necessities, semi-necessities, and low-priced convenience goods.

The volume of sales of food retailers was 22.07 per cent of total retail sales in 1929; it increased to 27.15 per cent in 1933 but declined to 25.5 per cent of the total yearly volume in 1934. There was a significant change in the relative importance of combination grocery stores and grocery stores without meat and meat markets. Combination stores in 1929 accounted for approximately 36 per cent of total food-store business; in 1933 the volume had increased to 47 per cent of the food total. The percentages of the sales of grocery stores and meat markets both declined. The automotive group of retailers accounted for 19.58 per cent of total retail sales in 1929; this percentage fell to 17.65 per cent in 1933 but increased to 18.9 per cent of total sales in 1934.⁴ The sales of mail-

¹ Cf. *Business Week*, p. 16, Sept. 1, 1934.

² The number of radio stores declined from 16,037 in 1929 to 8,172 in 1933. There were no stores, however, in this classification in 1920. *

³ The showing for this group was aided by the repeal of the Eighteenth Amendment.

⁴ There were 305,403 retail stores in the automotive group in 1933; 257,685 in 1929; only 28,768 in 1919; and 4,597 in 1909.

order retailers who use catalogues only recovered most rapidly during 1934 from the low points reached in 1932 and 1933. The increase in 1934 over 1933 was 25 per cent. This increase was doubtless due to the improved purchasing power of the agricultural districts. The sales of restaurants and eating places and of furniture and household retailers each increased 18 per cent over the 1933 sales volume. The reader can make a number of interesting and valuable comparisons by referring to the table.

Analysis of Retailers Classified on the Basis of Types of Operation.—

There were approximately sixty people for each store unit in 1934. The number of independent retailers declined 2 per cent from 1929 to 1933, or from 1,375,509 establishments to 1,349,337 (see Table 23). The independents accounted for 77.5 per cent of sales in the former year and for 71.2 per cent in the latter year. The number of mail-order retailers increased 15.0 per cent, or from 271 to 311, from 1929 to 1933. The sales of this group, however, accounted for only 1 per cent of total retail sales for each of the census years. Although the volume of sales declined 52.6 per cent, the relative position of the group did not change. The number of commissaries or company stores, it will be noted, increased 101.0 per cent; the relative sales position improved by one-tenth of 1 per cent. This was due to the fact that the volume of sales declined only 17.3 per cent. The number of stores operated by utility companies increased slightly; there was no change in the relative sales position, but the sales volume declined more than for all retailers combined, *viz.*, 53.4 per cent. This is approximately the same percentage decline as that suffered by the independents. The number of direct-selling retailers increased by the largest percentage, 323.0 per cent, or from 1,661 to 7,026. The relative sales position increased from 0.2 to 0.7 per cent, or $3\frac{1}{2}$ times. The volume of sales increased 99 per cent. The spectacular showing of this group is due, no doubt, to the large number of otherwise unemployed people who attempted to earn a living by selling merchandise from house to house.

We have no comparative figures on retail service establishments as no census was taken prior to the 1933 count. The *Census of American Business* counted 502,416 establishments selling personal services, business services, mechanical repair services, miscellaneous services, amusement and entertainment services, and hotel services. If we subtract the classification *business services*, much of which is not sold by retailers to individual consumers, we have remaining service establishments that sell chiefly to consumers.¹ With this adjustment, we have

¹ The reader will immediately recognize that this census did not purport to cover all retailers of services. Thus the services of the professions, transportation companies, governmental units, and many others are not included (*cf.* Chap. XII).

464,495 service retailers for 1933, who accounted for \$2,101,739,000, or or 76.12 per cent of the total amount reported for the entire service group. The personal service group, comprising 405,296 establishments, accounted for \$1,065,972,000, or 38.6 per cent of the total; 10,265 theaters secured \$415,153,000 of sales, or 15.04 per cent of the total; and 29,462 hotels did \$515,549,000 worth of business, or 18.67 per cent of the total.

TABLE 23.—COMPARISON OF RETAIL STORES BY TYPES OF OPERATION¹
(Sales are stated in thousands of dollars)

Type	Number of stores		Per cent change	Sales				Per cent change
	1933	1929		1933	Ratio	1929	Ratio	
Independents.....	1,349,337	1,375,509	- 2.0	\$17,826,562	71.2	\$38,081,504	77.8	-53.2
Chains.....	141,603	148,037	- 4.3	6,312,769	25.2	9,834,846	20.0	-35.8
Direct selling.....	7,026	1,661	+323.0	187,368	0.7	93,961	0.2	+99.4
Mail order.....	311	271	+ 15.0	244,381	1.0	515,237	1.0	-52.6
Commissaries.....	2,719	1,347	+101.0	95,578	0.4	115,583	0.3	-17.3
Utility operated.....	4,127	4,053	+ 1.8	76,079	0.3	163,371	0.3	-53.4
Other types.....	20,998	12,280	+ 71.0	294,488	1.2	310,151	0.7	- 5.0
Service establishments ² (adjusted).	464,495	No data for 1929	.....	2,101,739	.....	No data for 1929	.....	.....

¹ "Analysis of the Retail Census for 1933 According to Types of Operation—Chains, Independents, and other Types," Bureau of the Census.

² *Census of Service Establishments, Amusements, and Hotels, 1933.*

Chain stores improved their relative sales position from 1929 to 1933. The number of stores declined from 148,037 to 141,603, or 4.3 per cent. It will be noted that this was more than two times the decline of independents. The chains, however, secured only 20 per cent of the total retail merchandise business in 1929; their proportion increased to 25.2 per cent in 1933.

Geographical Distribution of Retail Stores and Retail Sales.—The effect of the depression on the volume of retail sales varied considerably in the different geographic divisions of continental United States. The decline in dollar volume for 1933 ranged from 53 per cent of the 1929 sales, in each of three divisions, *viz.*, East North Central, East South Central, and West South Central, to a decline of only 41 per cent in the South Atlantic division (see Table 24).

The Middle Atlantic and the Pacific divisions were slightly less adversely affected than the country as a whole, whereas the West North Central was affected adversely slightly more than the country as a whole. The retail sales in the various divisions apparently reflect the ill effects of the depression quite accurately. The relative position or rank of the various divisions, measured on a percentage of total retail sales basis, did not change. Thus the Middle Atlantic division, which held first

place in 1929, was likewise in first place in 1933. This division accounted for 25.9 per cent of total sales in the former year but increased its percentage to 26.5 per cent in 1933. The East North Central division retained second place in 1933. Its proportion of sales was 22.93 per cent in 1929, but it lost some of this in a decline to 21.22 per cent in 1933. The proportion of retail sales attained in the West North Central division declined from 10.73 to 10.55 per cent. The Mountain division remained at the bottom of the group and shows a decline from 3.15 to 2.95 per cent

TABLE 24.—COMPARISON OF STORES AND SALES BY GEOGRAPHIC DIVISION, 1933 AND 1929¹

Geographic division	Number of stores		Net sales			Percentage of total sales	
	1933	1929	1933 (000 omitted)	Per cent change	1929 (000 omitted)	1933	1929
United States.....	1,526,119	543,158	\$25,037,225	-49	\$49,114,653	100.0	100.0
New England.....	105,646	108,764	167,760	-43	3,785,869	8.66	7.71
Middle Atlantic.....	358,489	385,302	633,819	-48	12,717,899	26.50	25.90
East North Central.....	327,771	317,667	314,073	-53	11,262,958	21.22	22.93
West North Central.....	180,307	170,844	641,958	-50	5,269,554	10.55	10.73
South Atlantic.....	168,200	169,068	477,028	-41	4,201,755	9.89	8.55
East South Central.....	83,270	89,199	225,923	-53	2,171,995	4.10	4.42
West South Central.....	132,505	135,482	751,553	-53	3,727,371	7.00	7.89
Mountain.....	44,301	44,661	739,314	-52	1,548,650	2.95	3.15
Pacific.....	125,630	122,371	285,497	-48	4,428,602	9.13	9.02

¹ From *Census of American Business, Retail Distribution, 1933*, by areas, table published in *Domestic Commerce*.

of total sales. It is interesting to note (see columns 1 and 2 of the table) that some of the divisions, viz., East North Central, West North Central, and the Pacific, show increases in the number of stores while suffering a substantial decline in sales volume. The figures indicate, therefore, a drastic decline in the volume of sales per store in these geographic areas. Each of the other divisions, however, had a greater decline in volume of sales than in the number of stores, so they suffered a similarly unfavorable situation to a somewhat less degree.

Relation of Volume of Sales to Size of City.—The retail stores located in the larger cities, as might be expected, enjoyed a larger volume of sales per store than those in smaller cities. Thus 19 per cent of the retail stores were located in cities having a population of 500,000 and more. The volume of sales of this group, however, comprised 26 per cent of the total sales of the country. This fact is all the more noteworthy since this group of cities accounts for only 17 per cent of the total population.

The relatively favorable sales results may be explained by one or two possibilities, *viz.*, that the consumers in these cities enjoyed a more favorable purchasing power, and/or that the stores in these cities drew a substantial volume of trade from a wider area outside the city limits than was the case in the smaller cities. Table 25 presents in summarized form the data relative to stores and sales by size of city. The cities of 100,000 population and more contained 29.6 per cent of the total population of the country, 33 per cent of the total number of stores, and secured 46 per cent of the total volume of sales. Those cities having populations

TABLE 25.—UNITED STATES SUMMARY—PERCENTAGE OF STORES AND SALES BY SIZE OF CITY¹

City, size groups	Percentage of population	Percentage of stores	Percentage of sales
Totals, 1933.....	100.0	100	100
500,000 or more.....	17.0	19	26
250,000 to 500,000.....	6.5	7	11
100,000 to 250,000.....	6.1	7	9
All cities 100,000 or more..	29.6	33	46
75,000 to 100,000.....	1.8	2	3
50,000 to 75,000.....	3.5	4	5
30,000 to 50,000.....	3.9	4	5
20,000 to 30,000.....	3.2	4	4
10,000 to 20,000.....	5.6	7	7
5,000 to 10,000.....	4.8	7	7
2,500 to 5,000.....	3.8	6	5
All cities, 2,500 to 100,000.	26.6	34	36
All other areas.....	43.8	33	18

¹ "Stores and Sales by Size of City," *Census of American Business, Retail Distribution, 1933* (special report).

between 2,500 and 100,000 had 26.6 per cent of the population, 34 per cent of the number of retail stores, and secured 36 per cent of the total retail merchandise business. The remainder of the country, which had 43.8 per cent of the population and 33 per cent of the stores, accounted for only 18 per cent of the business. This group evidently comprises a large number of small retail outlets, since approximately the same number of stores, *viz.*, one-third of the United States total, had access to almost 44 per cent of the population yet secured only one-half as much business as the stores in the cities having populations ranging from 2,500 to 100,000, and less than 40 per cent of that received by an equal number of stores in cities of 500,000 and more population. The relative standing underwent practically no change from 1929 to 1933.

Food stores comprise 41 per cent of all retail stores in cities of 500,000 and more and secure 28 per cent of the total retail merchandise business. This same class comprises 23 per cent of all stores in areas of 2,500 and under and do 23 per cent of the retail business. Country general stores do a large proportion of the food retailing business in these areas. Seventy-eight per cent of the sales of apparel stores occurred in cities of over 30,000 in each of the census years. The cities between 10,000 and 30,000 and places under 10,000 each accounted for 11 per cent of the business of apparel stores. The lumber-hardware retail stores located in cities of 30,000 and more, secured 46 per cent of this type of business in 1929 and only 39 per cent in 1933. This type of retailer located in places under 10,000 did 40 per cent of this kind of business in 1929 and increased the amount to 47 per cent in 1933. The farmers-country general stores did 90 per cent of their business in places under 10,000 in 1929 and 87 per cent in 1933; they secured in 1929 only 6 per cent of the total business for this group in cities above 30,000 and 7 per cent in 1933.

The following quotation indicates how the number of kinds of retail stores and their volumes of sales are affected by the size of city.¹

The largest cities contain the greatest proportion of food stores, and 41 percent of all stores in such cities are food stores. In the areas of less than 2,500, the proportion of food stores drops to 23 percent; but country-general stores replace them, so that food stores and country-general stores combined constitute the same proportion of total stores as in the largest cities, or 41 percent. Food stores in the largest cities account for 28 percent of the total retail business in such cities, whereas their proportion in the small communities is 23 percent. At least one-half of country-general stores sales represents food; the 23 percent for food stores is thus increased to 36 percent, or more, which is a conservative measure of the proportion of retail business in the small communities representing the sale of food. Typically, food stores constitute about one-third of the total number of stores in an average city and they do about 30 percent of all retail business in such cities.

Restaurants typically constituted 13 to 14 percent of the number of retail stores and they account for about 5 percent of the total retail business of the average city. The smaller the city the smaller the proportion of retail business which is accounted for by the restaurants; on the other hand, in the largest cities restaurant sales represent 8 percent of all the retail business in such cities.

General-merchandise stores typically represent about 3 percent of the stores, but they account for 16 to 18 percent of the total retail business. This proportion falls off rapidly in cities below 10,000 population, where the proportion of stores

¹ "Stores and Sales by Size of City," *Census of American Business, Retail Distribution*, 1933, p. VII. This report contains tables showing for the United States and for each geographic area the number of stores and sales in each size-of-city group and tables showing similar information for each state.

is no less but their sales average only 5 percent of the total sales in the small towns and rural areas.

Apparel stores constitute as much as 9 percent of all stores in the larger cities and in characteristic cities of 30,000 to 100,000 they average 8 percent of all stores. Typically, they account for 9 to 10 percent of total retail business in the average city, but only 1 percent in areas under 2,500 population (This is the measure of apparel store sales, not of apparel sales).

Both motor vehicle dealers and filling stations increase in relative importance to other business in inversed proportion to population. In the largest cities they constitute 6 percent and 4 percent respectively of all retailers, and together they do 11 percent of the business. In cities between 30,000 and 100,000, the automotive group accounts for 16 to 18 percent of all retail places of business, equally divided between filling stations and other automotive. Filling stations in such cities do 6 percent of the total retail business of those cities, and the remainder of the automotive group (principally motor vehicle dealers) do 12 to 13 percent. In areas of less than 2,500 population, filling stations constitute 18 percent of all retail places of business and account for 11 percent of the entire retail sales in such areas, with the remainder of the automotive group accounting for 12 percent.

The furniture and household group in typical cities constitutes 3 percent of all retail stores and accounts for 4 to 5 percent of all retail sales in such cities.

Lumber and building material dealers in cities of 30,000 to 100,000 account for 4 to 5 percent of all retailers and the same proportion of sales.

Drug stores, almost without regard to the size of the community, constitute 4 percent of all retail stores and account for about 4 percent of all retail sales.

The Independent Retailers.—The independent store is one that is individually owned and operated. The typical independent retail store is small. It may be owned by a single proprietor, a partnership, or a company. It may be a member of a cooperative chain. In the latter instance it loses some of the characteristic features of the typical independent. The typical independent store is a limited-line store; there are, however, many independent variety, general merchandise, country general, dry goods, and department stores. The independent store is the most numerous of all retail stores and at the same time has the greatest aggregate sales volume. The limited-line store has been the dominant type of retail institution since it displaced the old country general store many years ago. This general store was a social institution as well as a marketing functionary. It was in this type of store that the people of the villages and countryside met to gossip, pass the time of day, discuss political, social, and religious questions, as well as to purchase everything needed in the home and on the farm. This local merchant was a buyer of a large portion of the farmer's produce. The general store was a high-cost institution because of its low rate of stock turn and high credit risks.

With the growth in population and increase in purchasing power there came a demand for greater variety, better quality, and lower prices. The unit store tended to specialize; thus there developed shoe, clothing, hat, grocery, drug, hardware, jewelry, musical instrument, dry goods, furniture, and other kinds of retail outlets.

The outstanding advantages of this type of establishment have been its wide assortment of merchandise in the line or lines stocked, convenient locations, and the personal attention given the whims and idiosyncrasies of the customers. The unit store has, on the other hand, some well-known disadvantages. One of its outstanding weaknesses is inefficient management. Since anyone with a few dollars can "start a store," many people who know little or nothing about buying and selling have entered the field. The mortality rate has been appalling. The Louisville survey indicated that thirty-two independent retail grocery stores were being opened in that city every month, and that an average of thirty were failing or going out of business during the same period.¹ The Buffalo survey of the mortality of retail grocery stores found that, of the 685 stores that started in business in 1926, only 32.5 per cent were in existence one year later; of the 734 that started in 1925, only 23.7 per cent were in existence two years later; while of the 569 that began in 1921, only 9.5 per cent were still in business six years later.² Dr. Julius Klein is reported to have made the following statement:³

Repeated analyses of failures and near-failures among retailers in all parts of the country bring out the fact that considerably less than 5 per cent of the failures among independents last year were due to competition. On the other hand, incompetence is responsible for anywhere from 32 to 80 per cent of the casualties in their ranks, dependent upon the locality and the trades involved.

Another element of weakness arises from their small volume of sales. This reduces their buying power and their opportunity to use, effectively, newspaper advertising. Attempts have been made recently to meet these two disadvantages by forming cooperative associations for buying, selling, and research. Considerable success is being secured by adopting many "chain-store" methods in the way of large-scale buying, standardization and simplification of merchandise lines regularly stocked, control of inventory, better store layout and stock display, and record keeping. There are now probably more independent stores which are members of voluntary chains than there are units in chain-store systems.⁴

¹ KALLBRENER, WALTER, "The Handwriting on the Wall for Grocery Manufacturers," *Sales Management*, July 6, 1929.

² MCGARRY, *Statistical Survey, University of Buffalo Bureau of Business and Social Research*, Vol. IV, No. 1.

³ "Chain Store Progress," p. 4, October, 1929.

⁴ Dr. Paul Nystrom.

Status of the Independent Store.—The independent limited-line retailer, because of his traditional weakness, views with suspicion and alarm the development of new and strange forms of competition in the retail field. The growth of the department store in the cities was regarded as a menace to the established trade. It was believed to be a part of the so-called trust movement and as such would eventually drive out the local small-scale retailers. While the department store grew rapidly and doubtless secured much business that would otherwise have gone to some of the poorly managed unit stores, the trade in time came to realize that the new organization filled an economic function in our marketing organization but that it could not displace the small retailer. The new institution grew because it supplied certain services more effectively and satisfactorily than the existing stores.

The next development to worry the retailers, especially those located in the villages and small cities, was the mail-order house. The local merchants attempted to create a public opinion hostile to the *new menace*. The commonly accepted method of meeting the situation was to appeal to the local community to "trade at home," "keep your money in the community," and "do not aid Wall Street, the trusts and monopolies." Legislation was resorted to in the vain effort to keep business from going to the mail-order houses. As in the case of the department store, this new institution met a real economic need of the farmer and the people in the small town. After a while the bitter feeling diminished and the position of the mail-order house was recognized and accepted.

A third disturbing factor appeared in the form of the house-to-house canvasser. We have had, it is true, pack peddlers and itinerant merchants more or less continuously since colonial days; however, it was not until after the close of the World War that the canvasser caused the local retailer much concern. Legislation was resorted to in an effort to keep out this undesirable interloper. The widespread use of this system, however, was its greatest weakness. The frequent ringing of the doorbell tended to annoy the housewife to such an extent that she developed a more or less hostile attitude toward the house-to-house salesman. The plan apparently has a place in our retail organization, yet its use is definitely limited.

The rapid growth, since 1920, of the chain store has, perhaps, excited the independent unit retailer more than the development of any of the other types. He has learned, after several years of experience, however, that he cannot prevent business from going to the chains, mail-order houses, and the department store by emotional appeals. He is beginning to recognize that the large-scale retailers have certain advantages in better management, locations, buying facilities, more balanced and timely stocks, and, in some instances, lower costs.

It may be said that the independent unit store has continued to grow in numbers all this time because it has a definite and important place in our marketing organization. The prosperity of the independent retailer as an individual merchant depends upon his ability to personalize his store and his services, to perform the functions of retailing in an efficient and satisfactory manner, and to supply his clientele with the kind, quality, style, and variety of merchandise and services when, where, and in the way they want them, and at the price they are able and willing to pay. As soon as he becomes aware of the fact that he must reduce his costs through more effective merchandising methods, he will be in a position to meet the large-scale retailers on a satisfactory basis, and make the most of the advantages that go with personalized small-scale retailing.

The following statement, attributed to Professor Nystrom, gives a well-balanced opinion concerning the competitive status of the small independent retailer.¹

The small store continues to be a field of opportunity for men and women with limited capital who want to run their own businesses. The requirements of retailing are much the same regardless of the type of ownership, and in their simplest terms are as follows: (1) A good location; (2) a suitable building; (3) layout and equipment that help to sell goods; (4) adequate lighting, heating, ventilation; (5) order and cleanliness; (6) merchandise which people want; (7) effective display of goods; (8) intelligent salesmanship and service that sells and makes friends; (9) advertising that brings customers to the store; (10) reasonable prices that customers are willing to pay. Two other necessities are competent management and adequate control. There is not a single one of these 10 requirements which cannot be as effectively provided by small independent stores as by chains or department stores.

The Operating Costs of the Independent Unit Retailer.—The high mortality rate among unit retailers has directed public attention toward the operating costs and volume of sales of this class of merchants. There is evidence to support the conclusion that there is a minimum volume of sales below which a retailer cannot go without being an economic burden to society. What this minimum is depends upon the kind and type of store and its location.²

The total reported expenses of independent retailers in 1929 were \$7,791,221,000, or approximately 15.8 per cent of total sales; in 1933 total reported expenses were \$4,529,250,000, or approximately 25.41

¹ From an address by Dr. Paul H. Nystrom, before the Fourth Annual Retail Conference at Pennsylvania State College, October, 1934. Summary reported in *Domestic Commerce*, Dec. 10, 1934.

² One study of 1,400 business bankruptcies in a metropolitan area revealed that one-half of the failures were due to poor management and that 62 per cent of the bankruptcies occurred among retailers.

per cent of sales.¹ Total reported expenses declined 41.9 per cent from 1929 to 1933, and total payroll expenditures declined 48.9 per cent; but, since sales declined more than expenses, the costs stated as a proportion of sales increased greatly during the period.

Total expenses of retailers vary considerably according to (1) kind of business, (2) volume of sales, and (3) location, *e.g.*, by geographical divisions, by size of city, and the location within the city, *i.e.*, central business district or outside this section.

The census of retailers in eleven cities² showed that the independents had 84.9 per cent of the stores but did only 71.9 per cent of the business. Twenty-eight per cent of the independents had annual sales of less than \$5,000, while 88.65 per cent enjoyed annual sales of less than \$50,000. Only 11.34 per cent of the independents succeeded in securing sales of above \$50,000, yet this group did 70.53 per cent of the total business done by the independent retailers. The 1933 Census revealed the fact that the independents comprised 88.4 per cent of the number of stores but accounted for only 71.2 per cent of the sales; in 1929 approximately the same proportion of stores secured 77.5 per cent of the total sales. Two-thirds of the stores in the State of Georgia, for example, had sales of less than \$10,000 per store in 1933; 56 per cent fell in this class in 1929. The big increase in the percentage of small-volume stores was due, no doubt, chiefly to the decline in prices. This group of stores, however, accounted for less than one-sixth of the retail sales of the state. Fifty-one per cent of the stores in the state were located in rural places, *i.e.*, in towns of less than 2,500 population, but the stores so located secured only 26.68 per cent of the total retail sales. Stores with annual sales of from \$1,000 to \$3,000 accounted for 21 per cent of the number of stores, yet these small-scale operators secured only 3 per cent of the sales. The situation was somewhat different in Connecticut where 25.4 per cent of the stores which secured 20 per cent of the total retail sales were located in rural places. Stores with annual sales of less than \$5,000 comprised 38.1 per cent of all retail stores of the state yet did only 4.4 per cent of the total volume of business.³

The great majority of independent retailers are clearly small-scale merchants. Sixty-four per cent of all stores in 1933 did less than \$10,000 of annual business and accounted in the aggregate for 13.85 per cent of

¹ These expense figures are not the total retail cost figures; no compensation for services of proprietors working in their stores and no interest on owned invested capital are included.

² "Retail Census Statistics of Eleven Typical American Cities," quoted from the *Retail Ledger*, first July issue, 1928.

³ MESSEROLE, W. H., "A Study of the Location of Small and Large Retail Outlets in Rural and Urban Places" (Georgia and Connecticut), *Domestic Commerce*, Mar. 20 and 30, 1935.

the total retail sales. This group comprised only 43.66 per cent of the total number of stores and secured only 5.69 per cent of total sales in 1929. Stores with less than \$50,000 annual sales comprised 94.39 per cent of the total number of stores in 1933. If we assume the net profit of this type of retailer to be 2.5 per cent, those having sales of \$5,000 and less will receive a maximum weekly profit of approximately \$2.40. Those having sales of \$50,000 will receive profits of less than \$25 per week.

The upper 25 per cent of the approximately 400,000 independent retail grocers do 65 per cent of all the business done by the entire group. The average volume done by a grocer in this upper group is more than five times as great as the average volume of the other grocers.¹

The National Retail Hardware Association made an analysis of some 1,267 reports received from hardware merchants.² This study showed that only 65 per cent of those reporting made a profit and that merchants having annual sales of less than \$40,000 rarely made a profit. Small stores in large cities experienced the greatest difficulty, while dealers located in towns of less than 10,000 population made the most money.

Total expenses for drug stores, classified according to geographic sections of the country (see Table 26), are given for illustrative purposes.

TABLE 26.—TOTAL EXPENSES OF DRUG STORES¹
(In percentage)

Eastern States	Central States	North Central States	Western States	Southern States	Middle Western States
27.8	27.1	25.5	29.1	28.2	33.0

¹ *Operating Expenses*, Merchants Service Bureau, National Cash Register Company. Figures originally collected by Druggists' Research Bureau, Cinchona Club, and Retail Druggists Association of St. Louis.

The costs in any particular geographical section will be affected by factors that influence the volume of sales, *e.g.*, weather conditions, purchasing power of the population—which is affected by the degree of prosperity enjoyed by the agricultural, industrial, and professional groups—and local habits and customs. Costs may vary as a result of differences in rent, interest rates, freight costs, salaries and wages, competitive situations, local or sectional taxes, and a number of other conditions.

Variation in costs, due to different locations within the same city, is indicated in Table 27. Some types of stores thrive in central business districts where absolute rents are high but where the relative rent expenditure may be low owing to the large volume of sales that can be secured in such locations. Other types of business must seek lower rent districts

¹ "Food and Grocery Facts," *Progressive Grocer*, January, 1934.

² Blue book issue of the *Hardware Retailer*, July, 1929.

outside the central shopping sections because they cannot hope to secure sufficient sales volume to pay the high absolute rents charged in the central shopping district.

The following statement by Mr. Rolph in the St. Louis report indicates the relation between location and costs of operation:

The average operating-expense ratio for all retail businesses combined is lower at locations in the rest of the city than in the central shopping district. Also the ratios are lower in the rest of the city than in the central shopping district for most retail businesses, considered by kind, and for most retail businesses considered individually; kinds of businesses for which the foregoing statement is not true are department stores; variety stores; and the highly specialized kinds of business, such as coffee, tea, and spices; millinery stores; custom tailors; and radio and electrical shops.¹

The data in the table indicate also the influence of the volume of sales on the cost figures. Stores with sales above the average tend to have lower expense figures than stores with a sales volume below the average. Individual differences among stores as well as among people are common. Under the heading variations in costs, the reader will note the wide range in costs among stores of the same kind. The median for each group is given. This figure is a representative indicator of central tendency. No explanation is available for the extreme variation in the costs among custom tailors, household-appliance stores, cigar stores without fountains, and music stores without radios. A guess is that sales volume was too low for a relatively high overhead cost.

Seventy of the 124 different kinds of retail stores studied were represented in both the central shopping district and the rest of the city. More than half of these 70 lines represented in both districts are conducted at a lower cost ratio in the central shopping district.

Department Stores.—The *department store* is a large-scale retail institution that is organized on a departmental basis and sells over the counter many lines of merchandise including, among others, dry goods, ready-to-wear, and notions. Some of the larger department stores have more than a hundred departments with a manager for each department. Many stores of this type claim to carry "everything for the home" and, in addition, merchandise to meet the needs of sport, outdoor life, and the automobile. More than 200,000 people have been known to enter one of the larger stores during a single day; the annual sales of one of the largest have been estimated in excess of \$100,000,000.²

¹ ROLPH and CARROLL, "Retail Operating Costs within a Metropolitan Community," *U.S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Ser. 88.*

² The *Census of American Business* states that the distinction (according to its definition) "between department stores and dry goods stores is that department stores sell a greater variety of merchandise than merely dry goods and women's apparel (usually including furniture or other household lines and men's lines), whereas

TABLE 27.—OPERATING COSTS OF INDEPENDENT RETAILERS IN A METROPOLITAN COMMUNITY, SHOWING VARIATION IN COSTS ACCORDING TO (a) INDIVIDUAL UNITS, (b) LOCATION, AND (c) VOLUME OF SALES¹
(Expressed as a percentage of sales)

Kind of business	(a)		(b)			(c)		
	Variations in cost among individual retailers located in central shopping district, per cent of sales		Location, total expense with estimated salary of owners, per cent of sales			Volume of sales in central shopping district, total expense with estimated salary of owners, per cent of sales		
	Range	Median	City total	Central shopping district	Rest of city	Total	Above average sales	Below average sales
Automotive accessory stores ²	17.6 to 38.9	28.5	27.6	30.8	26.8	45.4	42.3	57.4
Candy and confectionery stores ¹	16.8 to 45.6	35.5	36.8	34.3	37.4	45.4	42.3	57.4
Custom tailors	14.1 to 127.8	54.2	50.6	45.4	56.4	33.9	33.8	33.8
Family clothing stores	24.4 to 70.5	35.2	33.4	33.9	33.0	34.1	34.4	31.0
Fur shops	20.2 to 86.7	31.4	36.0	34.1	39.9	35.5	32.8	43.2
Independent department stores	20.9 to 43.6	31.9	27.3	27.0	31.8	35.5	32.8	43.2
Men's and boys' clothing stores	30.5 to 52.7	36.7	35.2	35.5	34.1	36.3	36.0	38.9
Men's furnishings stores	17.6 to 77.8	38.8	29.6	36.5	26.0	30.1	28.6	34.2
Shoe stores:								
Men's	19.9 to 42.3	31.5	29.6	30.1	25.3	30.2	28.8	34.6
Women's	19.2 to 50.1	30.1	29.8	30.2	26.7	32.1	29.2	39.2
Family	23.5 to 61.9	35.0	31.1	32.1	30.4	31.7	31.4	33.9
Women's ready-to-wear specialty stores	22.7 to 91.4	33.0	30.1	31.7	26.4	30.7	28.8	34.8
Furniture stores	16.1 to 46.7	27.9	33.7	30.7	34.8	36.6	34.0	43.8
Household-appliance stores	23.2 to 311.5	27.2	25.2	26.6	26.2	21.5	17.7	26.8
Radio and electrical shops	11.1 to 43.4	22.4	33.1	36.2	32.8	36.2	33.7	43.3
Radio and musical stores	30.7 to 84.3	36.4	35.5	38.7	31.5	38.7	34.3	45.8
Cafeterias	29.1 to 65.5	41.5	40.1	38.5	40.2	38.5	39.1	37.0
Lunch rooms	18.5 to 63.8	35.7	40.1	38.5	47.6	44.1	46.2	40.3
Restaurants	29.3 to 82.7	40.1	41.6	36.3	37.6	45.5	51.5	34.1
Buffet luncheonettes	13.0 to 94.1	38.0	36.9	36.3	44.1	44.4	38.4	50.5
Lunch counters	32.1 to 69.2	40.5	41.6	45.5	43.3	44.4	45.7	36.1
Soft-drink stands	23.0 to 92.7	54.9	36.4	44.4	33.8	44.4	22.9	25.5
Book stores	13.9 to 77.0	48.0	41.2	44.6	33.6	27.3	25.2	38.0
Cigar stores without fountain	9.1 to 101.3	28.0	27.8	25.8	29.4	25.8	22.6	40.5
Cigar stores with fountain	10.6 to 34.4	22.1	23.0	23.5	22.9	23.5	22.6	26.2
Coal and wood yards	20.0 to 61.2	25.5	26.3	24.8	26.7	24.8	22.9	25.5
Drug stores	30.2 to 72.1	38.5	26.5	31.2	26.0	27.3	25.2	38.0
Hardware stores	9.9 to 83.8	34.1	33.4	27.3	41.4	37.5	37.7	36.9
Jewelry stores—regular service	30.1 to 142.4	38.5	38.9	37.5	47.5	37.5	36.0	33.5
Music stores without radio	32.6 to 73.0	48.4	48.1	61.2	38.9	61.2	65.0	57.4
News dealers	30.6 to 79.5	49.9	48.6	50.9	41.3	50.9	47.4	57.4
Opticians and optometrists								

¹ Compiled from "Retail Operating Costs within a Metropolitan Community" (St. Louis), Bureau of Foreign and Domestic Commerce, U.S. Department of Commerce, 1924.

² Does not include estimated owner salary.

The American department store was developed and popularized by Stewart in New York, John Wanamaker in Philadelphia, and Marshall Field in Chicago. The rapid growth of cities, development of electrically driven street cars, daily newspapers, increased purchasing power of consumers, and constantly rising standard of living were important factors in making possible the growth of department stores. Since this type of retail institution operates on a large scale it must have, as a possible market, a large group of people concentrated in a relatively small area, such as a modern city. The store is usually located in the central shopping district so as to be easily accessible to a large portion of the population. The street car, elevated lines, and subways furnish acceptable transportation facilities from the outlying residential sections.¹ As the purchasing power of the urban population increased, the demand for greater variety, better quality, and lower prices grew. The department store management endeavors to meet this demand.

The Status of the Department Store.—This marketing institution had its most rapid growth from 1914 to 1921, although it has been an important factor in retailing since 1890. It grew because of the values and services given and the opportunity offered the women purchasers to "shop," i.e., to go about through the various departments, comparing qualities, prices, styles, and values, to their hearts' content.

Department stores declined in number from 4,221 in 1929 to 3,544 in 1933;² sales volume declined 41 per cent. Total sales in 1933 were reported as \$2,538,258,000. Employment declined almost 25 per cent, and the average earnings of the employees declined from \$1,243 to \$990, or approximately 20 per cent. This group of retailers did more than 10 per cent of the total retail business in 1933.

The early leaders in the field prided themselves on their ability to find and display new and unusual merchandise which could be sold at popular prices. Buyers were sent to all parts of the world in search of good values. The large volumes of sales which these stores are able to secure, because of their merchandise, location, advertising, services, and price policies, make possible certain economies, such as large-scale

dry goods stores appeal primarily or exclusively to women customers. A dry goods store with sales exceeding \$100,000 becomes a department store if, and when, it adds furniture, household appliances, hardware, and/or men's clothing and furnishing. If its sales are less than \$100,000 per year, it becomes a general merchandise store." *Retail Distribution by Areas*, Bureau of the Census.

¹ Before automobiles became so numerous, they furnished excellent transportation facilities to the down-town shopping district. Their almost universal use has brought such serious parking difficulties that a demand has arisen for stores located in outlying shopping districts where there is convenient parking space.

² The Census of 1920 reported more than 11,000 department stores. This larger number was probably due to the fact that a different definition was used at that time.

purchasing with quantity discounts, while a strong financial position makes possible cash discounts. The very size of the store tends to create prestige for the firm, makes possible departmentization, more specialized training on the part of executives and other personnel, and better control over costs, sales, and profits. The large size of the building permits effective layout of departments and striking displays of merchandise. Since the management appeals to a large portion of the population of the city and surrounding smaller cities, large newspaper space can be used to good advantage. The aim of the management is to *bring* people into the store and *keep* them in it as long as possible. Bargains in certain departments may be widely advertised to bring people in, with the expectation that they will see and buy other articles not advertised. Restaurants, beauty parlors, postal stations, rest and reading rooms, children's play rooms, libraries, lectures, movies, free parking privileges, and other forms of service are provided so as to make it unnecessary for the customer to leave the building until she has satisfied her needs. Charge accounts are solicited, and prompt deliveries of merchandise to the customer's home are made for the purpose of increasing sales volume.

This type of institution, however, has certain disadvantages. While the large size provides the opportunities for specialization and the economies mentioned above, the owner of the store finds it impossible to maintain the "personal" touch found in the small-scale retail stores. The clerks are hired, trained, and supervised by "hired" men; the buyers and other important executives may not have the interest of the owner in the success of the business. Many sales are lost and much ill will is created through the indifference of the personnel of a large department store. Attempts, through the use of stock-purchase plans, bonuses, benefits, gifts, and the like are being made more or less successfully to offset these disadvantages.

Competition among retailers to give more and better services, to have more pretentious buildings and equipment, and to dominate the market with advertising has tended to increase operating expenses more rapidly than gross profits can be raised. A slight decline in sales volume may be quite serious in such instances. High overhead, sales, and advertising expenses are characteristic of the department store.

Some of the small department stores have formed associations for buying so as to reduce the cost of merchandise purchased. Others have established branches in the suburbs or even in other cities; in a few instances chains of department stores have been organized. This plan proved somewhat disappointing during the depression years. The more satisfactory way, apparently, is to maintain local autonomy but to cooperate in purchasing to some degree not as yet clearly defined.

Independent department stores did 72.1 per cent of the department-store business in 1929 and 67.3 per cent in 1933; chain department stores secured 16.7 per cent of the business in 1929 and 23.9 per cent in 1933; all other types of department stores accounted for 11.2 per cent in 1929 and 8.8 per cent in 1933. The department stores owned and operated by the mail-order houses did 8.72 per cent of the 8.8 per cent reported by the "all other types" for 1933.

The number of independent department stores decreased from 2,166 to 1,428 between the two census periods. A factor in this decline is the minimum limit of \$100,000 which is required of a store before it is classified as a department store by the Census.¹ The number of chain department stores exceeded the number of independent department stores although their sales are little more than one-third of the sales of independent stores in this classification. With the exception of a few mail-order-house department stores and 121 stores of the "ownership" group,² practically all of the large down-town department stores of the country are independently operated and are locally owned.

Part of the increase in the number of chain department stores was due to the fact that the 1933 Census included about 100 more chain stores than the 1929 Census. A few of these were large stores opened by the mail-order houses and other chains which continued to expand after 1929; the balance represents principally the stores of a national chain classified in 1929 as a variety-store chain, but which changed the nature of its business during the intervening years until 1933, when it was classified properly as a department store chain. Its sales in 1929 were approximately \$66,000,000; in 1933 the sales were \$78,000,000. The departmental organization within each unit of a department-store chain is quite simple in character. This type of store does not place its merchandising emphasis on fashionable wearing apparel to the same extent as do typical independent department stores. Services are considerably more curtailed in chain department stores.³

Operating Costs of Department Stores.—Total reported expenses of department stores for 1933 were \$828,887,000, or approximately 32.65 per cent of reported sales; costs of independent department stores for 1933 were 35.4 per cent of sales; costs of chain department stores were approximately 27.42 per cent; and the costs of mail-order-house depart-

¹ See footnote, pp. 182 and 184.

² Ownership groups are financial mergers of previously existing independently owned stores without central merchandising and buying. Mere ownership does not classify (by the Census) them as chains so long as they are independently operated and their buying is not centralized. The same method of classification was used in both the 1929 and 1933 Censuses.

³ "Chain Store Expenses and Profits," *Harvard Bureau of Business Research, Bull.* 94.

ment stores were approximately 26 per cent.¹ There was a tendency for the costs of department stores to increase from 1925 to 1932. It will be noted (see Table 28) that the position of stores having net sales of less than \$500,000 is more unsatisfactory than that of those having sales in excess of this amount. The department store clearly needs a large volume of sales in order to show a profit. The stores with annual sales above \$2,000,000 made a more favorable showing in each of the five

TABLE 28.—OPERATING RESULTS OF IDENTICAL DEPARTMENT STORES¹
(Net Sales = 100 per cent)

Year	1929 volume of sales	Number of stores	Total merchandise cost (net), per cent	Gross margin, per cent	Total expense, per cent	Net profit or loss, per cent	Rate of stock turnover	Per cent of firms earning some net profit
1929	(a) Less than \$500,000	64	69.6	30.4	30.1	0.3	2.3	53.1
	(b) \$500,000 to \$2,000,000	69	68.4	31.6	30.6	1.0	3.7	63.8
	(c) \$2,000,000 or more	106	66.2	33.8	32.6	1.2	4.3	63.2
1930	(a) (Same as above)	64	71.3	28.7	31.9	L 3.2	2.2	23.4
	(b)	69	68.6	31.4	32.7	L 1.3	3.9	29.0
	(c)	106	66.4	33.6	34.1	L 0.5	4.3	48.1
1931	(a) (Same as above)	64	72.5	27.5	34.0	L 6.5	2.3	7.8
	(b)	69	69.1	30.9	34.9	I. 4.0	3.8	11.6
	(c)	106	66.8	33.2	36.1	L 2.9	4.3	21.7
1932	(a) (Same as above)	64	73.9	26.1	37.4	L 11.3	2.1	4.7
	(b)	69	69.3	30.7	38.9	L 8.2	3.5	4.4
	(c)	106	66.9	33.1	39.9	L 6.8	4.0	4.7
1933	(a) (Same as above)	64	68.5	31.5	35.3	L 3.8	2.1	12.5
	(b)	69	65.9	34.1	36.5	L 2.4	3.4	29.0
	(c)	106	64.0	36.0	38.3	L 2.3	4.1	*25.5

¹ Adapted from *Harvard University Graduate School of Business Administration, Bull. 92, 1934.*

years. Their profits were larger when profits were earned and their losses were less during the depression years. Gross margin for each group fell constantly for the years 1929–1932, inclusive. The decline was greatest in the low-volume stores. The large stores secured a higher rate of stock turn and enjoyed a lower net total merchandise cost. The more favorable showing for 1933 resulted chiefly from the fact that all groups were able to reduce their net merchandise costs and to increase their gross margin and at the same time reduce total costs below those of 1931 and 1932. These costs were, however, much higher in 1933 than they were in 1929 and 1930 when the profit situation was more favorable;

¹ Calculations based on Census-reported figures.¹

i.e., costs increased to a greater degree than gross margin. The condition of the department stores is strikingly emphasized when the percentage of firms earning some net profit in 1929 is compared with that of 1933. The items of expense that increased the most were salaries and wages, rent, and advertising.

It is believed by some students of marketing that independent department stores as a group have reached and passed their peak of growth. Their volume of sales apparently increased only about 20 per cent from 1920 to 1927. It is doubtful whether the development of department-store chains furnishes a means of more satisfactory marketing. The major problems of the department store are largely administrative. Costs have not been carefully controlled and consumer demand has not always been made the "merchant's guide." The profit trend, however, for 1934 and 1935 was greatly improved over that for the depression years.¹

The Mail-order House.²—This is typically a large-scale organization that does its selling by means of sales literature sent through the mails. The buying orders from the customers are received the same way, and much of the merchandise is delivered via parcel post, although heavy articles are sent by express and by freight. The mail-order house buys in large quantities and, in some instances, controls or owns manufacturing establishments.

There were 271 mail-order houses selling by means of catalogues only in 1929; the number increased to 311 in 1933, an increase of 14.8 per cent. Sales for this group, however, declined 52.6 per cent, and total payroll expenditures declined 45.4 per cent. Total reported expenses were \$68,446,000, or approximately 28 per cent of reported net sales. The largest item of expense is advertising.

¹ The Harvard report covering the year 1934 (*Bull.* 96) shows that 42 department stores with net sales less than \$500,000 in 1930 had in 1934 total expenses of 32.6 per cent, a net loss of 1.2 per cent on operation, a net gain of 1.9 per cent, and a stock turn of 2.5. One-third of the firms earned some net profit, and 73.8 per cent of the firms earned some net gain. Forty-two department stores with net sales of \$500,000 to \$2,000,000 in 1930 had in 1934 total net merchandise costs of 66.7 per cent, total expense of 34.0 per cent, net loss on operation of 0.7 per cent, a net gain of 2.6 per cent, and a stock turn of 3.7. Approximately 45 per cent of this group earned some net profit on operation, and almost 80 per cent earned some net gain. Seventy-four stores with sales of \$2,000,000 and more in 1930 had in 1934 total merchandise costs of 64.1 per cent, total expenses of 36.5 per cent, a net loss on operation of 0.6 per cent, a net gain of 3.2 per cent, and a stock turn of 4.6. Approximately two out of five in this group earned some net profit, and 85.1 per cent earned some net gain. These last figures indicate that the larger department stores enjoy the most favorable operating results.

² A distinction should be made between the mail-order house and the more or less incidental mail-order sales of the over-the-counter retail concerns. The latter is a method of selling which may be used by any type of selling organization.

There are two distinct types of mail-order houses—the *general*, of which Sears, Roebuck and Co. and Montgomery Ward are the outstanding examples, and a large number of specialty houses selling a restricted line, such as jewelry, articles of clothing, drugs, or tobacco products. The volume of sales of each firm, with the exception of the two leaders and a few others, has not been extraordinary. The net sales of Sears, Roebuck and Co. were approximately \$403,472,000 in 1929, and \$313,212,000¹ in 1934. These figures include sales of the department stores as well as catalogue sales. Returns and allowances amounted to almost \$40,000,000 in 1929 and to more than \$25,000,000 in 1934. Net income was approximately \$30,000,000 in 1929; \$15,000,000 in 1934; there was a deficit of \$2,543,651 in 1932. The net sales of Montgomery Ward were \$267,325,503 in 1929 and \$249,805,721 in 1934. These figures comprise both store and catalogue sales. Net income was almost \$13,500,000 in 1929 and slightly more than \$9,000,000 in 1934. There were deficits in 1931 and 1932. What proportions of the foregoing amounts were secured from catalogue sales is not definitely known. The mail-order sales of Montgomery Ward for 1934 were probably between 42 and 44 per cent of total sales.

The mail-order house grew rapidly during the first twenty years of the twentieth century. The farmer, during this period, was enjoying an expanding money income; at the same time his standard of living was advancing. He was reading more magazines and newspapers. There was a demand among the rural population, similar to that among the urban group, for greater variety and better quality merchandise and lower prices. The mail-order house serves the needs of the farmer in about the same manner as the department store serves the city people. The farmer and his family can sit at home around the dining-room table, look through the large catalogue, and shop at their leisure, write out the order, dispatch it by the rural mail carrier, and receive the merchandise within a few days' time. The convenience, wide variety, guarantee of satisfaction, and low prices appeal to the thrifty agricultural population.

By selling throughout the entire country the mail-order house developed a large volume of sales which gave it large purchasing power. Since it sells primarily for cash, it can pay cash and thus secure the benefits of cash discounts.

The mail-order house saves the high costs of salespeople, but its advertising expenditures are quite high. Since these marketing functionaries are able to locate their warehouses in low-rent districts, their

¹ An unofficial estimate divides this amount about equally between catalogue and retail stores sales. Sales in 1935 were running 25 to 30 per cent above those of 1934. This situation is a direct reflection of the increased purchasing power of consumers, especially the farm and small-town groups.

location costs are much less than those of over-the-counter retailers; their location in large cities tends to give them prestige among the country folk.

This type of retail institution, however, has some rather substantial handicaps, such as the desire of many people to see the merchandise before they buy. Articles of clothing that need to be fitted, such as shoes and suits, are more difficult to sell by mail; some merchandise is difficult to describe. The time element is another handicap—people do not like to *wait*. On the administrative side there are disadvantages, such as the risk of sudden price changes. Prices may rise or fall after the catalogue is printed. It is then difficult and expensive to make necessary changes. The depressions of 1921 and 1931 caused severe losses to the mail-order houses; on the other hand, the period of rising prices during 1918–1919 and 1933–1934 presented serious problems, as it is very difficult to raise prices shortly after lower prices have been published in a catalogue. Sears, Roebuck and Co. is reported to have distributed 300 carloads of catalogues in the early part of 1935; each catalogue weighed approximately 3 pounds; the total weight of the books was approximately 9,000 tons.¹

The Status of the Mail-order Business.—Local merchants tried in many different ways to create public opinion against mail-order house goods. The merchandise was called cheap and inferior, and the people who sent their money out of the neighborhood were considered poor citizens.

The mail-order business grew in spite of the disadvantages and the hostility of the local merchants until the chain store, the automobile, and good roads appeared. The tendency of the farmers and small-town people to drive to the larger cities to shop and attend shows adversely affected the mail-order business. The managements recognized the changed situation and met it by establishing retail stores in large and medium-sized cities. Sears, Roebuck and Co. established its first store in 1925. On January 31, 1933, Montgomery Ward was "operating 493 retail stores; 17 were department stores, 457 were chain stores, and 19 were tire and radio stores."² The total number of stores was reduced to 489 by January, 1934; plans were announced during 1935 to increase the number to 500 by the beginning of 1936. Sears, Roebuck and Co., in June, 1935, was operating 69 Class A or department stores, 304 Class B, 51 Class C stores, and 4 agencies, a total of 428.

¹ Montgomery Ward is reported to have 20,000,000 customers; the firm transacts business in every state in the Union, in Canada, and in many other parts of the world. The company had 31,500 employees in April, 1934. *Moody's Manual, Industrials, 1935.*

² *Moody's Manual—Industrials, 1934.*

The large mail-order firms have speeded up their deliveries and in various ways are making strenuous attempts to increase their volume of sales.¹ The two large mail-order houses show large sums on their balance sheets in accounts receivable and for real estate mortgages and repossessed homes. The highly competitive situation caused them to abandon their cash-only policy for credit sales in substantial amounts. The guarantee of satisfaction or money-refunded-without-question policy is, no doubt, necessary but adds materially to the costs of operation. Returns and allowances for one of the large mail-order houses, for example, amounted to approximately 9 per cent of gross sales in 1929; this item declined, however, to approximately 7 per cent in 1933. Late in 1934, mail-order houses—Montgomery Ward and Sears, Roebuck—introduced telephone order taking on a more or less experimental basis. The customer makes his selection of merchandise from the regular catalogue and then telephones his order to the store or mail-order plant. Delivery is made within 24 hours on a C.O.D. basis. A delivery charge is added to the price of the merchandise. The response of customers to the new plan “was beyond expectation and repeat orders were numerous,” according to reports.²

Consumers' Cooperative Retail Stores.—This type of retail institution is relatively unimportant in the United States but is quite important in the United Kingdom and Europe. These stores were developed as a protest against high prices and the profits which merchants and other middlemen were thought to receive at the expense of the consumer. It was thought that goods could be purchased by the consumer cooperative stores direct from the producers and sold to the cooperating consumers at a lower price by eliminating the profits of the middlemen and some of the services commonly given by retailers, such as credit, deliveries, an expensive location, and fancy fixtures.

Cooperative buying on the part of consumers is for the purpose of *saving*, i.e., buying their merchandise at a lower price than can be secured from the retailer. The cooperative urge among this group is strongest during periods of unemployment and low income. Unusually high commodity prices, which reduce real wages, and a long-drawn-out business depression seem to promote the desire for cooperation. The cooperative idea is more readily understood and appreciated by noting its origin and early development. The leaders of the movement in the United States, especially among the consumer and the agricultural groups, secured much of their inspiration and information from the

¹ During part of 1929 the two largest mail-order houses paid the transportation charges on a large list of merchandise. This practice was abandoned in 1930, but credit was extended for a limited volume of purchases of a selected list of articles.

² *Business Week*, Nov. 17, 1934.

Rochdale Society of Equitable Pioneers of Great Britain. A brief discussion of this movement furnishes a useful background for an understanding of the American development.

The Rochdale Society of Equitable Pioneers.—During the first half of the nineteenth century England was experiencing the turmoil resulting from the Napoleonic wars and the Industrial Revolution. Unemployment, low wages, and an inequitable tax system reduced large numbers of the common people to a state of poverty and misery. Economic and social conditions were particularly bad among the factory workers of Rochdale. Their unfortunate lot, the failure of the Rochdale Savings Bank, and the unsuccessful strike of the flannel weavers in 1844 stimulated a few of the more far-seeing workers to investigate the merits of the cooperative retailing plan advocated by Owen and the Brighton Pioneers. The men of Rochdale developed methods which eliminated the principal weaknesses of these earlier cooperative movements.

The original plan was quite comprehensive, yet in practice the group exercised especially good judgment.¹ The weavers began with a cooperative retail store. They started conservatively, on a small scale, and added new lines of merchandise as their finances and membership warranted. As they grew stronger, manufacturing was added to retailing, and branch stores were opened in other towns. The workers soon recognized the possibility of increasing the purchasing power of their wages through cooperative buying, producing, and banking.

Rochdale Principles of Cooperation.—How accurately these pioneers in the cooperative movement diagnosed the difficult situation that confronted them is indicated by the policies of organization and operation developed. They recognized the necessity for democratic control and the danger of clique control, the possibility of loss from granting credit, the difficulty of trying to sell goods at cost because cost cannot be accurately determined until the goods are sold and paid for, and the desirability of furnishing some inducement for capital and patronage. The policies formulated by the pioneers are summarized in the following words:²

1. Only one vote could be cast by each member, irrespective of the number of shares held.
2. The number of shares which one member could hold was limited.
3. The business was on a cash basis, and services rendered were reduced to a minimum.

¹ Among the stated purposes of the organization were the following: to establish and operate a retail store, to provide houses for members, to establish factories for producing certain articles and to provide employment for needy members, to secure farm land to be cultivated by needy members, and to establish a self-supporting colony. Filley, H. C., *Cooperation in Agriculture*, p. 19.

² *Ibid.*, p. 21.

4. All merchandise was sold at regular retail prices; this practice not only simplified their accounting problem but also tended to prevent severe price cutting with independent dealers.

5. The rate of dividend paid on the capital stock was limited to the current rate of interest.

6. Earnings in excess of dividends were divided among the members on the basis of the amount of goods purchased.

One of the first rules established was that no paid officer could be a member of the board and that no member of the board could be a paid officer.

Success of the British Cooperative Movement.—The development was not without disappointments and opposition. Some members showed little interest and loyalty. They would go to other stores when more convenient, and on slight provocation. The cooperatives were opposed by business men in general and by the local merchants in particular. The management, however, was able to overcome all obstacles until now the idea has developed into the British Cooperative movement which is the largest and one of the most successful business enterprises in the world.¹ Almost 7,000,000 of the 11,000,000 families of Great Britain were members of cooperatives in 1934. The organization has stores in England, Scotland, and Ireland. The production of its factories is five times greater than that of the private manufacturers in the manufacturers' associations. It owns and operates wholesale houses, manufacturing plants, coal mines, flour mills, tea plantations in Ceylon and India, wheat fields in Canada, coffee plantations in Brazil, and ships to carry the products to Great Britain. The largest bakery in the world is owned by the cooperators of Glasgow. The soap works of the British Cooperative Wholesale Societies produce 500 tons of soap a week, and their factories make 4,000,000 pairs of shoes annually. The total sales of the 1,150 societies federated in the British Cooperative Union in 1933 were more than £210,000,000; the net surplus saving was £27,000,000. The largest retail society in the world is the London Cooperative Society, with 500,000 members, 12,000 employees, £7,600,000 capital, and £10,000,000 turnover in 1933.² Concerts and entertainment are provided, and the societies operate large and powerful banking and insurance companies.³

¹ WARRASSE, AGNES D., *The Story of Cooperation*.

² WARRASSE, JAMES PETER, "Consumers' Cooperative Methods," *The Annals of the American Academy of Political and Social Science*, May, 1934.

Mr. Warbasse further states that the cooperatives were the original chain stores. They continue to lead in this field. "European cities well know their chains. The Hamburg Cooperative Society has over 500 stores; the Stockholm Society has 340; the Leeds Society has 246."

³ WARRASSE, AGNES D., *Bull. of the Cooperative League of America*.

The foregoing facts clearly indicate that the Rochdale cooperative movement has grown into a tremendous integrated producing and marketing organization. This type of cooperative organization is well suited, apparently, to a highly industrialized and densely populated district, such as Great Britain, whose deficiency in raw materials and food products is pronounced.¹

Consumer Cooperative Stores in the United States.—Consumers in the United States have frequently organized buying clubs, retail stores, and, less frequently, wholesale establishments for the purpose of reducing the costs of marketing, eliminating unnecessary services, and securing fair and honest treatment. The obvious purpose is to supply the members with merchandise at lower prices. Two thousand cooperative retail societies with approximately 528,000 members, doing an annual business of almost \$180,000,000, were operating in the United States at the close of 1925. By 1934 the cooperative movement had developed to such an extent that 3,500 consumer cooperative organizations, with a membership of close to 1,500,000, did an annual business estimated at \$365,000,000. The following statement suggests the extent of the movement:

Although consumers' cooperation is not so strong in America as in the countries of Europe, nor even so well established as the cooperative marketing movement among the farmers, nevertheless it does occupy a significant place in the lives of several hundred thousands of farmers and industrial workers. In 1928 there were approximately 1,700 cooperative store societies, the larger number of them in the rural districts, although the societies doing the largest business are situated in the cities. The biggest of all, in point of membership and turnover, is the Franklin Cooperative Creamery Association, distributor of milk and other dairy products to thirty or forty thousand consumers of Minneapolis. This organization has 5,000 shareholder members and annual sales in excess of \$3,500,000. The Cooperative Trading Company of Waukegan, Ill., has sales of nearly \$700,000 and distributes groceries, meats, its own bakery products, and milk. Consumers Cooperative Services of New York City, with more than 3,000 members, operates eight cafeterias and restaurants. The Soo Cooperative Mercantile Association, at Sault Sainte Marie, Mich., the largest business institution in the city, operates a bakery and a chain of eight retail stores which do a business of \$650,000 annually. The Cloquet Cooperative Society of Minnesota has a membership of 1,300, composed of mill workers and farmers, and has a turnover of \$550,000. There are cooperative bakeries owned and operated by consumers in 22 cities and towns throughout the country. The cooperative restaurant, cafeteria, and

¹ Cooperation among the agricultural producers has not developed to such a high degree of success. It is estimated that nineteen in every hundred English farmers are members of an agricultural cooperative society, and twenty-eight in every hundred do at least part of their business with a society. These societies have not for the most part taken on other than a local significance. *New York Journal of Commerce*, Aug. 22, 1930.

boarding house societies number 27. Ten cooperatives are distributing milk. Hundreds are handling gasoline and oil,¹ and in several states wholesale oil companies have engaged in a multitude of miscellaneous services, such as the distribution of coal, water power, telephone service, operation of book stores, etc. Federations of local consumers' societies have formed cooperative wholesales in Seattle, Wash., Superior, Wis., Omaha, Neb., and New York City. The Cooperative League of the United States of America is the central educational union for the movement, supported by its constituent membership. It publishes a monthly magazine, conducts an accounting bureau, provides legal service to its members, sends out speakers and organizers, conducts a correspondence school and local resident training schools for employees and others, gets out a cooperative yearbook and other publications, and conducts every second year a National Cooperative Congress. The League is the only member of the International Cooperative Alliance from the United States.²

The movement among consumers in the United States has not, generally speaking, met with great success. The explanation for the lack of success of the movement in the United States is probably the highly individualistic character of the American workman, the relatively high money income and rising standard of living, and poor management of the stores. The American people, apparently, want to be free to buy where and when they please. The cooperative idea tends to restrict their selection. Unless they are driven to these stores by economic necessity, it appears that the American workmen will not turn, in large numbers, to such organizations. It is difficult to develop and maintain an organization that will continue to give wholehearted support to the idea. The movement has been confined, in the main, to the working class. This group, in the United States, has received fairly high wages and has not felt the need to save the pennies to the same extent as have the workers in some other countries. Our population comprises many different races and nationalities; these peoples lack the feeling of permanence and solidarity that is present in an old-world community. There is a high degree of independence and individuality among the middle class which hinders the development of the cooperative movement. No pressing need, except perhaps in a few more or less isolated instances, exists for a change from the private system.

The large-scale retailers at present are meeting the needs of the consumers in a fairly satisfactory manner. Some students of marketing

¹ There has been a remarkable growth in the number of retail outlets and in the volume of sales by this group since 1930. Dr. Warbasse stated in 1934 that there were 1,800 oil cooperatives in the Middle West and they "are becoming so numerous and so powerful as to have the private oil men in a state of jitters." Some pay patronage dividends as high as 25 per cent. The development has been greatest in Wisconsin, Michigan, and Minnesota.

² *Recent Economic Changes in the United States*, *op. cit.*, Vol. I, Chap. V, from a note by H. W. Laidler, director.

believe, however, that there is little difference in the cost of doing business between cooperatively and privately owned marketing concerns.¹ The appearance of the large-scale retailers with their emphasis upon values at low cost has probably tended to discourage consumers from developing, on an extensive scale, the cooperative method. The cooperative store, however, stands as a safeguard against monopoly or gross inefficiency on the part of the existing retail regime. If the chain store, for instance, should establish a monopolistic position in the retail field, as some people fear, the cooperative movement would probably experience a rapid growth.

Commissary Stores.—Commissary stores are retail establishments owned and operated by a company or an individual for the ostensible benefit and convenience of the employees of the firm or individual. These stores are usually operated by industrial firms, mining and lumber companies, plantation owners, and governmental units. They are normally located in places not adequately supplied with retail services by other types of retail organizations. This kind of store is likely to appear when the employees and employer feel that prices charged by other retailers are too high and when satisfactory credit terms are not provided. These two conditions are the more likely explanations for governmental commissaries.

The company store may use its monopolistic or semi-monopolistic position to the disadvantage of the customers. Exorbitant prices are sometimes charged, and stringent credit terms exacted. The company is in a favorable strategic position from a credit point of view. Since the customers are employees, payment of bills contracted at the store may be secured by deducting the amount from the pay check. A combination of high retail prices, unwise credit obligations, and slack work may put the employee in a very undesirable economic and social position.

The total volume of sales of this type of retail store is relatively unimportant, since it accounted for only three-tenths of 1 per cent of total reported retail sales in 1929 and for four-tenths in 1933. The amount was \$115,583,000 in 1929 and \$95,578,000 in 1933. The decline was 17.3 per cent, which was less than the decline in retail prices; consequently, the physical volume evidently increased during the period. There were 1,347 such stores in 1929 and 2,719 in 1933, or an increase of 101 per cent. The increase was probably due to the severe decline in employment and the failures among local independent retailers which caused more employees to desire the services of a company store where credit would be available. It seems logical, however, that as the country becomes more densely populated, as methods of transportation and communication are improved, and as the economic position of the

¹ Cf. Nystrom, P. H., *Economics of Retailing*, Vol. I.

employee improves, the company store will lose much of its usefulness and will decline in importance.

This type of store apparently enjoys low operating costs. The *Census of American Business* reported an expense ratio of approximately 14 per cent compared with 25.41 per cent for independent retailers, 27 per cent for chain stores, and 28 per cent for mail-order catalogue houses. We cannot determine from the reports, however, whether the customers received any benefits from these low costs in the form of lower prices.

Utility-operated Stores.—This is a special form of company store. It is not operated, however, for the convenience of the employees of the company but to encourage and promote the sales of appliances so as to increase the consumption of the major product of the utility company. Gas companies and electric power companies are very active in promoting the sales of all forms of appliances that will increase the sales of gas and electricity. They have, at times, been accused of selling the appliances at prices below costs to the disadvantage of other dealers in similar appliances. Independent dealers in some states have instituted active campaigns to secure the passage of state laws which prevented the utilities from engaging in the retailing of appliances. Where such laws were passed, they have been, in almost every instance, declared unconstitutional.

There were 4,053 utility-operated stores in 1929 and 4,127 in 1933, an increase in percentage almost equal to the increase in the number of independent retailers. The volume of sales declined from \$163,371,000 in 1929 to \$76,079,000 in 1933, or 53.4 per cent. This decline was again approximately equal to the percentage decline in the sales of all independent retailers. Utility-operated stores accounted for approximately 36.8 per cent of the total sales in the appliance classification, while independents secured about 33.2 per cent. The total volume of sales of the utility stores, however, was only three-tenths of 1 per cent of the total reported retail sales for each of the two census years 1929 and 1933. This type of store, however, appears to have a high expense ratio. The percentage for 1933 was approximately 39.8 per cent of net sales.

Retail Service Establishments.—This group of retailers comprises, in the main, small-scale operators, with the exception of a relatively small number of large hotels and theaters. The personal-service retail establishments, such as barber shops, beauty parlors, cleaning, dyeing, pressing, repair, and valet shops, laundries, photographic studios, shoe-shine parlors, and shoe repair shops, have a larger number of proprietors than full-time employees. The number of employees of funeral directors and embalmers was approximately 1.3 times the number of proprietors.

The number of retail service establishments bears a close relationship to the density of population. Since services are perishable and cannot be

transported and stored, the establishments must be located in places convenient to the customers. Five states—New York, Illinois, California, Pennsylvania, and Ohio—accounted for more than 50 per cent of the service, amusement, and hotel receipts of the United States in 1933. New York State secured 22.8 per cent of the total receipts. These same states contain 40 per cent of the establishments.¹

Summary.—The retail store constitutes the final step or link in the marketing organization or structure. Since it is in direct contact with the ultimate consumer, its management is in a strategic position to determine the wishes of this group of buyers with reference to prices, quantity, quality, style, and service. Because of this situation the retailer assumes the role of purchasing agent for the consumer and selling agent for the producer and the wholesaler. The retailer performs in varying degree all of the marketing functions. Competition for sales volume has caused many retail managements to add various forms of services which have greatly increased operating costs and to cut prices which have reduced gross margins, with the result that the mortality rate, especially among independent retailers, is extremely high. Since it is so easy to start a retail store because of the small amount of capital required and the liberality of credit extension on the part of wholesalers, producers, and the manufacturers of equipment, many individuals with inadequate training and experience enter the field only to fail. This situation produces a high turnover rate among the retailers operating near the margin. The total number remains so large that the volume of sales for thousands of independent retailers cannot be large enough to support low-cost operation. The inefficient practices of this marginal group prevent many efficient retailers from enjoying profitable results.

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Questions for Discussion

1. What are the functions performed by the retailers? Which of these are the most important? Upon what bases may retail stores be classified? Which is the best basis for understanding the retail phase of the marketing problem? Why?
2. What is the origin of the itinerant merchant? The general store? The specialty store? The department store? The mail-order house?
3. Is there any positive force in the economics of marketing which makes for large-scale organization?
4. Enumerate the advantages of large-scale retailing and give the salient points of each advantage. What are the outstanding disadvantages of large-scale retailing? Do you think the advantages outweigh the disadvantages? Justify your answer.
5. Account for the development of each of the following methods of retailing, indicating the advantages and disadvantages of each: (a) department store, (b) mail-order house, (c) utility owned. What are the future possibilities of each?
6. What is the present status of company stores? Why did they develop? What is likely to be the trend in the future?
7. "I don't think that even the wildest witch-hunters of Salem ever hated witches more eloquently than the small-town merchants hated the mail-order ogres . . . nor did the witch-hunters ever dance with greater glee around a burning witch than the small local chambers of commerce around a pile of flaming mail-order catalogues. In spite of the annoyances of this unfair competition, the mail-order houses grew into tremendous distribution organizations." How can this development be explained? Is the more recent development of the chain store an analogous situation? Justify your answer.

Assignment

1. Problem 2, p. 5. Muscadine Company—Mail-order Business.
2. Problem 1, p. 86. Sears, Roebuck and Co.—Mail-order, Chain, and Department Stores.
3. Problem 2, p. 91. Montgomery Ward & Company—Mail-order, Department, and Chain Stores.
4. Problem 3, p. 99. Jadwin-Atlantic Company—Manufacturers' Retail Branches.
5. Problem 1, p. 41. Robert Brown—Cooperative Store.

CHAPTER VII

THE ELEMENTS OF OUR MARKETING ORGANIZATION—RETAIL FUNCTIONARIES—CHAIN STORES

Purpose of this chapter: To analyze the causes of the rapid growth of the corporate chains; to determine their advantages and disadvantages; to compare their operations with those of the independents.

The chain store is one of the more recent developments in the general trend toward large-scale retailing. A chain-store system comprises a group of retail establishments of essentially the same type, centrally owned, and with some degree of uniformity of operation. The regular lines of merchandise carried, the kind and quality of services sold, and the policies and operating methods followed are determined and controlled by a central administrative group. Some of the chains have effected a high degree of standardization with reference to external appearance of the building, store front, window displays, interior layout and store displays; kind, quality, amount, and brands of merchandise sold; and services furnished. The distinguishing features, however, of the retail chain are multiple units and central ownership and management.

Classification of Chain-store Systems.—Chains may be classified on the basis of type of business organization into (1) corporate chains and (2) voluntary chains. The first is the orthodox chain that has led the development. The second is a voluntary association comprising independent retailers who, under their own cooperative leadership or through sponsorship of some wholesaler or other leader, endeavor to secure some of the advantages ascribed to the corporate chains while continuing to enjoy the advantages of individual ownership. These groups usually cooperate with reference to buying, sales promotion, and store operation. Some students of marketing do not consider the voluntary groups as chain organizations. Since they have some of the characteristics of both chains and independents, arguments can be, and have been, developed to justify both points of view. It is not necessary for our purpose to make a decision at this time in favor of either point of view. We can analyze and study the developments in each instance without further discussion of the minor points.

Chains may be classified, on the basis of geographical location, into (1) national, (2) sectional, and (3) local chains. *The number of national chains is relatively small, yet they operate the major portion of the units; e.g., the 1933 Census reported 63 chains in the variety-store field, with*

5,344 units.¹ Three chains owned 2,540 of these units, while the other 90 chains owned about 2,800 units. Thirty-four department-store chains had 3,072 units, yet the three largest chains in this class had 2,259 of the total stores.² Twenty-four of the chains had 10 or less stores each. In the variety-store group 55 of the 93 chains had 10 or less stores each; in fact, 28 of them had less than 6 stores each.

Chains may be classified, on the basis of the kinds of merchandise or service offered, into food or grocery chains, variety-store chains, theater chains, restaurant chains, and so on. These different bases of classifications are useful at various points in our discussion.

Branch stores are not chain stores. They are merely subsidiary retail outlets owned and operated by some established store. The original store is known as the central or parent store and usually furnishes much of the merchandise stocked by the branch or branches. The subsidiary store typically carries a more limited line of merchandise than the parent store. There are a few instances in which a number of stores are owned and controlled by a holding company. The individual stores, however, are operated under separate and distinct managements. There is little or no evidence of central control of merchandising, sales promotion, and store operation.

There seems to have developed a decided trend on the part of a number of large department stores to establish branches in outlying shopping districts of large cities, in near-by prosperous suburban towns, and, in a few instances, in cities far removed from the parent store. None of these cases is a true chain system. On the other hand, there is no essential difference in the fundamental services performed by a unit of a chain system and those of a single independent store. The success of each depends upon knowing what, when, and how much the community wants in the way of merchandise and services; securing a favorable location for the particular type of store to be operated; intelligent buying plus the benefits of quantity purchases which the independent may secure through cooperation; developing an intelligent and well-trained personnel; and operating an adequate system of control. The chains, generally speaking, have placed greater emphasis upon all these points than the average retailer.

When Is a Chain a Chain.—How many units make a chain? This is a perplexing question. The Census Bureau decided more or less arbi-

¹ The Census definition of a variety chain is a group of four or more units owned and operated centrally, selling general merchandise within price limits ("limited prices") not exceeding \$1.

² About two-thirds of the stores of these chains were classified by the Census as department stores; the other one-third primarily as general merchandise stores. The chain classification does not include ownership groups which do not have "central merchandising and buying."

trarily that four units make a chain. The Federal Trade Commission in its Chain-store study decided that two units were sufficient to form a chain system. Some students of marketing believe that no definite number is necessary—that there may be two-store, three-store, and other multiple-unit classifications. They believe, in other words, that a number limitation is not one of the distinguishing features of the chain so long as the group comprises two or more units. Other specialists in the marketing field believe that we do not have a real chain unless there are twenty to twenty-five units. They contend that the small groups have so many characteristics of the independent merchant that they should be so considered. They argue, for instance, that these groups do their buying largely from wholesalers and do not have the advantages of large-scale operation.

Although the Census decision is arbitrary, its method of classification is perhaps as useful for our purpose as any. The Census figures can be used more conveniently if its classification is followed. We shall therefore follow the Census practices to a considerable extent.

The Economic and Social Position of the Chains.—Much criticism and objection have been directed at the chains. The organization and direction of this resistance have their source in various associations formed by independent retailers and wholesalers. These associations have succeeded in securing state legislation that provided discriminatory taxes against the chains and investigations by the Federal Trade Commission and by Congress. When the codes were formulated the associations were active in securing and in trying to secure provisions that would react to the disadvantage of the chains. Provisions, for example, were inserted against price cutting and the use of "loss leaders," quantity discounts, and advertising allowances. The associations kept up a constant stream of propaganda directed to the public and to the politicians, charging the chains with evading local taxation, paying low wages, working their employees long hours, using loss leaders, selling low-grade merchandise, giving short weights and measure, sending money out of the home town, being too impersonal in their relations to the public, having no civic interest, and not supporting local charities and other similar enterprises. While some of these charges frequently had an element of truth in them, the consumers in general were not greatly impressed. They continued to believe, if we can judge by their actions, that their money would buy more merchandise at the chain store than at the typical independent.

It is difficult to forecast how the movement will progress. The chains can be driven out of business through taxation if the state legislatures follow the lead of the associations. If, however, retail prices rise to a great extent as a result, the consumer is likely to exert great pressure

against the increase in taxes, because he will discover that in the end he will be the one who really pays the taxes through higher retail prices.

The economic justification of the chain systems is summarized as follows, by E. C. Sams.¹

To put it briefly, the chain-store system is of economic value to a community to the extent that it provides better values, insures regular rentals, stabilizes real estate values, makes sound credit, furnishes regular and dependable employment, permits participation in some way in profits, seeks to serve an ever widening trade area for the natural type of merchandise that it needs, educates and trains its working personnel into a deeper understanding of community service and the best methods of merchandising procedure.

Mr. Sams, in September, 1934, made the following statement in defense of the chain store:²

1. They have largely eliminated retail exploitation of unprotected localities through a policy of one price, plainly marked.
2. They have established a higher standard of storekeeping; with better sanitary standards, with more attractive displays and with more convenient shopping facilities.
3. They have increased the attractiveness and quality of merchandise and made available a variety to more isolated sections through mass production and mass distribution.
4. They have gone a long way in eliminating waste in distribution with untold savings to their customers.
5. They have placed a desirable emphasis upon a cash—or pay as you go—policy among the general public, particularly as to the every-day needs of life.
6. They have created a generally improved type of merchant not only within their own ranks but by example and competitive necessity among their wideawake competitors who have profited from proximity to ably managed stores.
7. They have increased consumption through lowered prices, with a consequent increase in productive employment and with improved standards of living.
8. They have partially checked the tendency of people in suburban or rural areas to flock to the cities, because they have brought to thousands of main streets more of the advantages often associated only with metropolitan centers.

A more disinterested opinion as to the importance of the chain store is expressed by Dr. Julius Klein,³ who is reported to have made the following statement in a public speech.

Let there be no mistake about the admitted contributions of the chain toward the betterment of distribution in general. Within the past decade the chain has

¹ President, J. C. Penney Co., "The Economic Contribution of a Chain Store to Retailing," p. 21, from a speech delivered before the National Retail Dry Goods Association.

² *New York Journal of Commerce*, Sept. 26, 1934.

³ *Chain Store Progress*, p. 4, October, 1929.

unquestionably introduced us to new methods of waste elimination in that field of our business endeavor which is most in need of just such improvement. The chains have evolved new methods of stock control, of merchandise display, of cost accounting, of weeding out unprofitable items—in a word, of watching many of these details which so frequently spell disaster for the unwary tradesman.

Professor Nystrom¹ supports, in an indirect way, the general ideas advanced by Mr. Sams and Dr. Klein when he says,

Under equal conditions of selling chain stores probably have no advantages over independent stores in operating expenses. If their expenses are sometimes lower, it is not because of chain ownership but rather because of greater efficiency in operation. In the matter of buying the independent can parallel every advantage enjoyed by chains if he will but associate himself with other small purchasers for the purpose of obtaining his goods on the same basis as chain stores. There are now more independent stores organized in so-called voluntary chains or cooperative buying organizations than there are units in the chain stores.

The Federal Trade Commission, on the orders of Congress, spent several years and a considerable sum of money in making a thorough investigation of all phases of chain-store organization, ownership, operation, and practices in general. The final report was published in 1935. The following statement summarizes the reasons advanced by the Commission, explaining why the chains can maintain a lower selling price to the consumer:

The chief advantage enjoyed by the chains is the ability to maintain a lower selling price to consumers.² These lower prices are due largely to a variety of factors, viz.,

1. The usually lower buying prices of chains as compared with independent wholesalers or retailers, much of which is often the result of special discounts and allowances to chains. . . .
2. The extensive use by the chains of large proportions of leader and loss-leader merchandise sold at prices which are below the average cost of doing business plus the cost of the merchandise and which are sometimes below the latter.³
3. More extensive short and less extensive overweighting by chains in some localities than by independent stores on commodities sold by weight.
4. Less service given to customers by chain stores as compared with independents on the average (free delivery service, telephoned orders, etc.)⁴

¹ From an address delivered at the Fourth Annual Retail Conference at Pennsylvania State College, October, 1934.

² "Chain Stores—Final Report on the Chain-store Investigation," *Senate Document 4*, pp. 85 f., 1935.

³ These conditions, chain-store operators declare, were effectively eliminated by operation of the grocery codes.

5. The indicated lower wages paid by the chains in some localities at the time of the inquiry.¹

6. Elimination by the chains of most of the wholesale selling expense. . . .

7. The wider profit margins on private brand merchandise as compared with standard brands.

8. Profits from wholesaling operations. . . .

9. . . . Chains in many lines possess an important advantage through their ability to use newspaper advertising where the independent retailer cannot afford to do so. . . .

10. A final and very important advantage of the chain consists in its ability to average the profit results obtained from its stores in various localities, the low prices obtained in one or more areas being offset by the higher prices obtained in one or more other points. This ability of the chain to average its prices may contribute materially to its ability to use leaders and loss leaders effectively.

The Rise of the Chains.—The rapid growth of chains is a good indication of the economic value of the chain-store idea. The following figures collected by the Federal Trade Commission, while not purporting to cover all chains in the United States, give, nevertheless, a good idea of the rapid development of chain stores during the period 1915–1930. These figures are derived from the reports sent to the Commission by the number of chains indicated.² The sample is believed to be large enough to be truly representative.

TABLE 29.—GROWTH OF CHAINS IN THE UNITED STATES

Year	Number of chains	Number of stores	Net sales
1915	63	3,695	\$ 255,894,981
1920	285	13,949	1,292,529,335
1925	920	38,955	2,741,571,506
1929	1,180	60,992	5,370,809,900
1930	1,203	64,891	5,338,590,300

These figures clearly demonstrate the phenomenal growth of the chain store system during the fifteen-year period. The number of chains increased almost twenty times, the number of stores increased more than seventeen times, and the volume of sales increased more than twenty times.

The Censuses of 1929 and 1933 give us a complete picture of the chain-store situation for these two years. There were 148,037 chain stores in 1929, with total sales of \$9,834,846,000. The number of stores decreased 4.4 per cent, to 141,603, by 1933; the total sales for this year were \$6,312,769,000, a decrease of 35.8 per cent.³ These figures, in addi-

¹ Also corrected by the retail grocery code, according to operators.

² Chain Stores—Gross Profits and Average Sales per Store of Retail Chains," Federal Trade Commission, Report on Chain Stores, Document 178.

tion to reflecting the severity of the depression, furnish a basis for comparing the Federal Trade Commission sample for 1929 with the 1929 Census count. The chains increased their relative position in the retail-store field during the depression. They accounted for 20 per cent of the retail-store business in 1929; the proportion secured in 1933 was 25.2 per cent.

Chain stores have been organized and successfully operated in several foreign countries, especially in Canada, England, Egypt, Germany, Austria, and Japan. The Hoshi Pharmaceutical Company, Japan, for example, is a "drug chain of 2,000 units and has 5,000 more planned."¹ The following quotation from *Domestic Commerce* indicates the recent retail developments in Great Britain.²

Although there has been a tremendous growth in the number of retail shops in Great Britain in recent years (over 600,000 now in existence), the expansion of department stores, chains, multiple shops, and cooperative societies has been the outstanding development in retail trade. Of the total of over 600,000 shops, about 10 per cent are owned by large firms; but this 10 per cent accounts for over 45 per cent of sales. One large group controls 3,700 shops; a large importing concern operates 2,300; one tailoring firm supplies one-fifth of the men's suits sold.

There has been little outcry by the small merchant against the large retailer, contrary to developments in other European countries; in Denmark no firm is permitted more than one shop in each municipality or parish; in France multiple shops are specially taxed; in Germany the opening of new uniform-price stores is prohibited, and a special turnover tax is imposed on chain stores; in Norway the trading license permits trading in only one fixed place; in Switzerland the extension of stores by opening a new department or more fixed-price stores is prohibited; in Canada the Government has been investigating chains and department stores.

The development of large retail units has affected the manufacturers. With the growth in the size of factories it became essential to secure a regular outlet for the product and certain manufacturers have met this problem by establishing chains of retail shops. This enables the producer to obtain first hand information on changes in public taste and buying power and to regulate his output accordingly. In other cases manufacturers have endeavored to foster a steady demand for their products, by establishing a "goodwill value" through brands and advertising, to insure that their goods will be stocked by retailers.

With the growth of large retail groups centralized buying has developed as far as is practicable. Large retailers, because of the size of their purchases, are able to place orders directly with the manufacturer at low prices, thus eliminating the wholesaler. Wholesale houses for the most part have retained only smaller distributors who require credit.

Fluctuating prices and rapidly changing styles and tastes cause shop-keepers to order in smaller quantities and at frequent intervals, adding to wholesalers'

¹ BAXTER, W. J., *Chain Store Distribution and Management*, p. 7.

² PETERS, HORACE W., "Modern Developments in Distribution in Great Britain," *Domestic Commerce*, p. 140, Mar. 30, 1935.

expenses. Large retail units are able to take the whole output of a manufacturer who will install the necessary plant to furnish speedy delivery in quantity; the wholesaler is now expected to handle the output of the factories with a small or irregular production or of specialized articles having limited turnover. The turnover and profit margin of British wholesalers have thus suffered severely in recent years.

It is reported that the shares of large retail establishments rank among the safest industrial investments. During depression years only a few dividend payments have been curtailed; in many instances there has been an increase in payments to shareholders.

It is interesting to note the report of a nation-wide retail organization corresponding to American 5 and 10 cent stores. During the year 1934 it opened 69 new branches, bringing the total of its stores to 600, located in all the principal cities of the country. Besides the establishment of these new branches, 37 of the older stores were enlarged or remodeled. This company reported a net profit of \$4,879,949, an increase of approximately 6% over 1933.

The number of chain stores in the United States increases at a more rapid rate than that of independents. The new-store-opening rate is higher for independents than for chains, but the closing rate is nearly as high as the opening rate for independents, while the closing rate for chains, according to the Federal Trade Commission, is only about one-fourth the opening rate.

The Effect of the Depression on Chain-store Sales.—The various kinds of chains did not fare equally well during the depression, when compared with independents. Chains in five classifications, viz., department stores, shoe stores, combination grocery and meat stores, cigar stores, and drug stores, improved to a considerable extent their position relative to independents. Another group of five chains, comprising variety stores, men's stores, women's apparel stores, restaurants and eating places, and filling stations, improved its position only slightly when compared with the independents. The relative position of a third group of five chains, made up of family clothing stores, furniture stores, radio stores, grocery stores without meat, and jewelry stores, remained unchanged or actually declined when compared with independents.¹

What Kinds of Merchandise Are Sold in Chain Stores?—A wide variety of goods is sold through chain stores. There are many different kinds of chains, such as grocery, drug, candy, variety, shoe, apparel, department store, automobile supplies, tire, radio, tobacco, hotel, restaurant, newspaper, laundry, theater, and many more. A classification on the basis of major line of merchandise carried or service performed does not possess the significance it did in the early development of the idea. Thus the drug chains have entered the food and lunch-counter field, and

¹ "Chains and Independents and Other Types of Operation, 1933," *Census of American Business*.

some sell books, hardware, cutlery, sport and optical goods, electrical appliances, and variety goods; grocery stores are selling cigarettes, meat and poultry products, drugs, candy, ice cream, beverages, and hardware; cigar stores are selling candies, food, and novelties; men's hat shops are selling clothing and accessories; men's clothing chains have added women's sport lines; variety stores sell food products, lunches, beverages, piece goods, and articles of clothing; shoe stores sell hosiery and dress accessories.

In What Fields of Retailing Have the Chains Been Most Successful?—Chains have tended to concentrate in a relatively few lines of retailing, although there are a few chains in almost every field of retailing. Thus variety chain stores did 91.2 per cent of the total business transacted by variety stores in 1933; chain shoe stores secured 46.2 per cent of the shoe-store sales; chain grocery stores without meat secured 45 per cent of the sales of this type of grocery store, a decline from 45.7 per cent enjoyed in 1929; chain combination stores, *i.e.*, grocery and meat, secured 43.7 per cent of the sales of this classification in 1933, an increase from 32.2 per cent in 1929. A Census report for 1933 states in this connection,¹

The trend toward combination food stores (grocery stores with fresh meat departments), was pronounced in the period between 1929 and 1933. The movement toward the inclusion of meat departments in grocery stores started with the smaller chains in the years prior to 1929, and the larger chains were testing it out in relatively few stores at the time of the 1929 Census. Since then it has become the predominant kind of chain food store. The increase in chain ratio, from 32.2 percent in 1929 to 43.7 percent in 1933 without any change in ratio in the grocery field, reveals the transition of many chain units from grocery stores to combination stores without corresponding movement to the same degree among independent grocery stores.

It will be noted from the foregoing that chains seem to prefer to operate food, variety, and drug stores and filling stations. The favorable relative showing of the chains during the depression period is due in the main to the large proportion of business done by the chains in these lines of business. The independents operating these kinds of retail stores suffered least in volume of sales during the same period. More than one-half the chain-store volume of sales was secured in the four above-mentioned fields. The chains had relatively small representation in the retail fields hardest hit during the depression. The leaders in this type of retailing evidently are aware of its weaknesses as well as its strength.

Size and Geographical Distribution of Chains.—The Federal Trade Commission received reports from only nine chains that had 1,001 and more stores. The 1929 Census found that less than 10 per cent of the

¹ *Ibid.*

chains had more than 1,000 stores. This group, however, owned about one-half the chain stores and did about 40 per cent of the volume of chain-store business. Only 337 chains out of a total of 7,061 chains had more than 50 stores each; 70 per cent of all chains did not have more than 10 stores each. These figures indicate that the chains are not the mammoth organizations sometimes pictured. There are a few, however, of national and international scope that own and operate a large number of stores. In the grocery field, for example, one chain—the Great Atlantic & Pacific Tea Company—was reported as having more than 15,000 stores in operation at the beginning of 1934, located in 35 states and 2 provinces of Canada. The firm owned 62 warehouses, 32 bakeries, 6 salmon canneries in Alaska, 5 manufacturing plants, 2 cheese plants, 2 laundries, and 1 printing plant. The number of employees was approximately 90,000. Sales for 1929 amounted to \$1,053,692,882, with net profits of \$26,219,681; sales for the year ending February 28, 1934, were \$819,616,729; the tonnage sales for the year were 4,962,543. The margin of profit for 1929 was approximately 2.5 per cent; for 1934 it was 2.91 per cent. Another chain, Kroger Grocery and Baking Company, operated more than 4,300 retail outlets, which secured sales of \$221,175,330 in 1934; approximately 2,761 of these contained meat markets. The average weekly sales per store in 1934 were \$968. The stores were located in 1,463 cities in 18 states; several grocery departments are located in some of the Sears, Roebuck department stores. The Kroger Company employs more than 22,000 people. The margin of profit in 1934 was 1.91 per cent of net sales. This company owned and operated 10 bread and cake bakeries, 3 meat-packing plants, 4 dairies, 4 coffee-roasting plants, 1 sausage plant, and a general plant for packing candies, spices, teas, coffees, and extracts. Safeway Stores, Inc., was operating 3,228 stores at the beginning of 1935; 2,085 of these contained meat markets. This organization operates 21 bakeries, 71 warehouses, and 4 creameries. In addition to groceries and meats, this chain sells vegetables, fruits, candies, beverages, cigarettes, mops, and small kitchen utensils, and some units have drug departments and lunch counters. The stores are located in 20 states and the District of Columbia; there are 179 stores in Canada. Nine stores formerly operated in Hawaii were sold in 1934. The company employs almost 17,000 people. Net sales for 1934 were almost \$243,000,000; the margin of profit was 1.93 per cent.¹

The *Progressive Grocer* estimates that small local grocery and combination chains, i.e., chains with four to twenty-five stores, had a sales volume of \$287,000,000 in 1933, and the sectional and national chains

¹ Some of the other large chains are the Woolworth, Kresge, and Grant organizations.

had sales of \$1,922,000,000. The total retail food and grocery sales in 1933 are estimated by the same authority at \$7,781,415,000; in 1933 chain stores selling food products are estimated to have secured 33 per cent of the total amount. The Census for 1933 estimated total sales of grocery and combination stores—chains and independents—at \$6,144,-884,000;¹ the chain-store proportion is placed by the census at 43.7 per cent of the total sales of grocery and combination stores.

There is wide variation in the proportion of total sales of grocery and combination stores secured by chains in the various geographical districts. The chains in these two kinds of food chains account for 46 per cent of the total volume of sales in the New England division, 47 per cent in the Middle Atlantic division, 41 per cent in the East North Central division, 36 per cent in the Pacific division, 31 per cent in the South Atlantic division, 24 per cent in the East South Central division, 23 per cent in the Mountain division, 19 per cent in the West North Central division, and only 18 per cent in the West South Central division. There is wide variation among states as well. Grocery and combination stores in Rhode Island and the District of Columbia secured 53 per cent of the total sales of grocery and combination stores in 1933; similar chains in Massachusetts, Connecticut, and New Jersey secured 49 per cent of total sales in each state. Chains in the same classification secured 40 to 48 per cent, inclusive, of total sales in each of the following states: Michigan, New York, Pennsylvania, Delaware, Ohio, Illinois, and California. The lowest proportion of grocery and combination store business secured by the chains was in Mississippi and Minnesota, where the amount was 11 per cent. The chains secured 12 per cent of the business in Arkansas; and 13 per cent in Montana, North Dakota, and South Dakota. The stores of these chains are concentrated largely in the eastern part of the country. There is apparently a close correlation between the location of these chains and the density of population and the industrial development of the territory. Map 4 shows by states the number and sales of all retail stores, number and sales of independent stores, and the number and sales of chain stores.

In 1929 there were 105 local variety chains with 772 stores; in 1933 there were only 59 of these local chains with 535 stores. The number of sectional and national chains was 43 in 1929, with 4,675 stores; in 1933 there were 34 chains, with 4,809 stores—an increase of almost 3 per cent

¹ This figure does not include the sales of meat markets, bakeries, fruit and vegetable markets, candy and confectionery stores, beer and liquor stores, or dairy stores which are included in the estimate by the *Progressive Grocer*. These figures, however, do not contain, according to G. M. Lebharr, editor of *Chain Store Age*, the sale of grocery products by Woolworth, Grant, Kresge, and other 5 cent to \$1 chains. If these were included the percentage of grocery sales by chains would be higher than the *Progressive Grocer* estimate.

in the number of stores. The number of chains, however, showed a decline of 30.7 per cent.

The total sales of the local variety chains declined 42 per cent from 1929 to 1933, while the sales of the sectional and national chains declined only 22.8 per cent. The sales of the locals amounted to only approximately one-fortieth of those of the sectional and national chains. The sale of meals comprises almost 5.4 per cent of the total sales volume of variety-store chains. There were 20 local department store chains with 103 stores in 1929; the number of chains declined to 17 with 100 stores in 1933. The number of sectional and national chains was 13 in 1929, with 2,457 stores; the number of chains increased to 17 in 1933, with 2,972 stores—an increase of almost 30 per cent in the number of chains and almost 21 per cent in the number of stores. The total sales of the local chains decreased 6.7 per cent from 1929 to 1933, while the decline for the sectional and national chains was only 3.5 per cent. The total volume of sales of the local chains, however, amounted to only about one-eighth of those of the sectional and national chains in 1933.

Some Chain-store Practices.—The competitive position of the chains, especially the larger ones, is no doubt improved because of discounts and allowances received from manufacturers. The reader is reminded, however, that practically all chains have developed from a single independent store which secured no unusual purchasing advantages in its beginning. The discounts and allowances secured may be grouped under three headings, *i.e.*, *volume discounts*, received because of the amount of merchandise purchased from the manufacturer;¹ *advertising allowances*, discounts given in recognition of the prestige of the buyer and in return for the newspaper advertising, window, counter, and store displays, and other forms of sales promotion furnished by the merchant; and *miscellaneous allowances*. Not all manufacturers, of course, give allowances or discounts to chains, wholesalers, and voluntary chains.

The average rate of allowances on total sales of all manufacturers to chains in 1929 and 1930 was approximately twice the amount received by wholesale and cooperative chains, according to the Federal Trade Commission report. The average discount received by the chains was 1.89 per cent in 1929 and 2.02 per cent in 1930; while that received by cooperative chains was 1.00 and 1.04 per cent and by the wholesalers 0.87 and 0.91 per cent for 1929 and 1930, respectively. Only 253 of

¹ The volume discount may be in the form of "straight volume allowances, no quotas or increases specified; volume allowances with a quota specified; progressive discounts increasing with volume; and discounts for increases in volume over some prior period." W. H. S. Stevens, "A Comparison of Special Discounts and Allowances in the Grocery, Drug, and Tobacco Trades," *Journal of Business of the University of Chicago*, July, 1934.

the 457 manufacturers reporting in 1929, and 273 of the 464 reporting in 1930 gave allowances to chain, wholesale, or cooperative dealers.

The following summary statement, by Mr. Stevens,¹ indicates the importance of volume and advertising allowances in the grocery, drug, and tobacco trades.

Importance of Volume and Advertising Allowances.—1. From the point of view of the amounts of money paid, advertising allowances are of outstanding importance in the tobacco trade, over 80 per cent of the 6-7 million dollar total going for this purpose, as compared with less than 13 per cent for volume. In both the grocery and drug trades, on the other hand, larger amounts are paid for volume than for advertising and promotion, though only slightly so.

2. Measured by (a) the number of manufacturers making allowances, (b) by the number of dealers receiving them, and (c) by the number of times they are reported, advertising and promotional allowances are more important than volume allowances in the grocery and tobacco trades, the reverse being generally true in the drug trade.

3. Measured by the total amounts of the allowances paid, volume allowances are relatively more important to wholesalers than to chains in all three lines, and advertising and promotional allowances more important to the chains.

4. Measured (a) by the number of dealers obtaining allowances and (b) by the frequency with which they are reported, advertising allowances in the tobacco and grocery trades are relatively more important to the chains than to the wholesalers, and volume allowances more important to the wholesalers than the chains; but measured by the number of manufacturers giving them, advertising and promotional allowances are more, and volume allowances less important to wholesalers than to chains in these two kinds of business.

5. Measured (a) by the number of manufacturers reporting and (b) by the frequency with which they are reported, advertising allowances in the drug trade are relatively more important to the chains than to the wholesalers, and volume allowances more important to wholesalers than to chains; but measured by the number of dealers receiving allowances, both volume and advertising allowances are more important to the wholesalers than to the chains.

6. However, in three out of the four sets of criteria employed, the advertising and promotional allowances are relatively more, and volume allowances relatively less, important to the chains than to the wholesalers.

* * *

In conclusion it deserves to be pointed out that the special discounts and allowances shown by this study do not necessarily represent the full buying advantage of the chains as compared with the wholesaler-retailer system of distribution. The Commission's price and margin studies for groceries and drugs in four different cities show quite definitely that, although the drug-chain buying prices are lower than those of the wholesaler, chiefly because of special discounts and allowances, such concessions represent only a part of the lower buying prices of the chains in groceries.

¹ *Ibid.*

Chain Prices Compared with Independent-store Prices.—The studies made by the Federal Trade Commission seem to establish rather decidedly the facts that chains, on the whole, sell at lower prices than independents, have lower merchandise costs, and operate on lower margins. The Commission found in Detroit, for example, that the totals of the unweighted retail selling prices of the 256 items included in the principal margin study were \$144.73 at the independent drug stores and \$129.67 at the chain drug stores.¹ The independent drug-store prices were therefore 11.62 per cent higher than corresponding chain-store prices. When these prices are weighted by chain-store quantities, the independent-store prices are 17.87 per cent higher than chain prices. A similar investigation among the drug stores of Washington, D.C., showed the unweighted prices of 226 drug-store items in independent stores to be 10.72 per cent higher than in chain stores.² When the prices were weighted by chain-store quantities, the independent-store prices were found to be 27.75 per cent higher than the chain-store prices. In Cincinnati³ the unweighted independent drug-store prices were 9.80 per cent higher than the chains; when weighted the prices were 22.68 per cent higher than those of the chains. The Commission found that the unweighted independent-store prices for 120 items sold in the grocery stores of Cincinnati were 6.35 per cent higher than the prices of the larger chain grocery stores and 5.74 per cent higher than the prices of the smaller chains.⁴ When the prices are weighted by the independent-store volume, their prices are found to be 9.22 per cent higher than those of the larger chains, and 9.28 per cent higher than those of the smaller grocery chains.

Price Policies among the Chains.—How do the chains determine what price to charge for their merchandise? The following quotation from a Federal Trade Commission Report gives us some valuable information.

Pricing at a set average mark-up cost is the rule most frequently reported by the chains. Next in order is the rule that prices are set by competition, which in turn is followed by the policy of selling at fixed retail prices determined in advance of the purchase of the goods, as exemplified in 5- and 10-cent store chains. The latter policy is not confined, however, to the policy of selling at a limited number of fixed retail prices, but includes any policy of buying goods to sell at predeter-

¹ Federal Trade Commission Report, "Chain Stores, Detroit," *Senate Document* 96.

² Federal Trade Commission Report, "Chain Stores, Washington, D.C.," *Senate Document* 98.

³ Federal Trade Commission Report, "Chain Stores, Cincinnati," *Senate Document* 95.

⁴ Federal Trade Commission Report, "Chain Stores, Cincinnati," *Senate Document* 88.

⁵ Federal Trade Commission Report, "Chain Stores—Chain-store Price Policies," *Senate Document* 85.

mined retail prices. When a set mark-up is employed, the cost of the goods is treated as the basic figure and retail prices are set so as to provide the desired profit. When, on the other hand, fixed retail prices are the starting point, the purchase prices paid for the goods must be low enough to yield the chain its profit. The difference between the two methods is a difference in emphasis; the former presumably stimulates the chains to reduce their operating expenses as a means of increasing net profit, while the latter tends rather to emphasize reduced purchase cost as the source of increased profit.

Chains may follow a rule of pricing at a certain average mark-up over the cost of the goods; but, because of their policy of featuring specials or leaders, they cannot get an adequate mark-up on such goods and must make up the difference on other merchandise. Discussion of pricing methods by a number of chain officials interviewed illustrates with considerable detail the various ways in which the losses or absence of profit on staples and leaders are offset by the higher margins obtained on other goods, and in this respect the present report supplements the report on chain-store leaders and loss leaders. Two chain officials criticize the consuming public for demanding excessive price reductions on some classes of goods while paying without complaint more than a reasonable price for other classes.

Sixty-two per cent of the reporting chains have no rule against pricing goods below net purchase cost, and 74 per cent of them have no rule against pricing goods below net purchase cost plus cost of doing business. Chain-store officials discussing such rules show that those chains that have them frequently permit exceptions, while those that do not have them say it would be impossible to live up to them.

About two thirds of the 1,500 reporting chains state that they retain exclusive control of selling prices and also of mark-up in central headquarters, the range being from about 20 per cent of the department-store chains to 100 per cent of the hat and cap chains. About one seventh of the chains give exclusive control of selling prices and of mark-up to their store managers, while one fifth of them divide control of these matters among central headquarters, subheadquarters warehouses, and store managers.

Although 70 per cent of the 1,673 reporting chains claim that their selling prices are identical in all their stores, the great majority of chain stores and sales reported are on a nonuniform price basis. The 502 chains which reported the selling prices of their stores as not being identical account for about two thirds of all stores and seven tenths of all sales reported. This is due to the fact that the larger chains show a greater tendency toward price variation than the smaller, and to the fact that approximately three fifths of all stores and sales reported belong to grocery and meat, dollar-limit variety, and department-store chains, which lines are to a much larger extent characterized by price variability than any of the other 23 lines of chain business studied.

Price variability is influenced not only by kind of business and by size of chain but also by the geographic extent of the chains. For example, larger proportions of city chains of specified sizes report uniform prices than is true of chains operating in one state, or geographic division, or in two or more divisions.

About one quarter of all chains reporting variations in selling prices state that their prices vary between different sections of the country, while a trifle over three quarters report their prices as varying between different cities in the same section, and only three tenths state that their prices vary within the same city.

* * *

Differences in costs of goods and differences in the costs of transportation frequently cause nonuniformity of prices in intercity chains and especially in the case of intersectional chains. Also, where the stores of a chain in different cities buy some merchandise locally, differences in the cost of the goods tend to result in nonuniform selling prices for such goods. Again, differences in overhead and in costs of operation, such as rent, salaries, taxes, and other local expenses may cause prices of stores situated in different geographic sections, in different cities of a section, or even in different parts of the same city to vary.

The prices of a chain may vary, too, because of the volume of business transacted, the amount of credit and service extended, the local business conditions encountered, and sometimes simply because the chain can get more from the class of people served in one locality than it can get elsewhere.

But competition is the most frequently reported single reason for price variation, including variations due to the lowering of prices in certain stores of a chain for the purpose of meeting or underselling local competitors, or for the purpose, as they call it, of "stimulating business."

Operating Expenses of Chain Stores.—The *Census of American Business* published the "reported expenses" of all chains for 1933 at \$1,710,754,000. This amounts to 27.10 per cent of total reported sales. We cannot determine whether this is an accurate expense figure since we do not know what adjustments, if any, have been made for allowances and discounts received, for interest on own investment, and for several other expense items. We may be quite sure, however, that central office and warehouse expenses are included so the figure equal to 27.10 cents on each dollar of sales includes what corresponds to the combined costs of the wholesaler and the independent retailer. Thus the Census figures show the costs of independent retailers to be equal to 25.41 cents on each dollar of sales, but to get a figure comparable with the chain-store expense figure we must add the expenses of the wholesalers to those of the independent retailers.¹

The total central office and stores expenses of variety-store chains were reported as 30.81 cents per dollar of sales for 1933;² the corresponding figure for department-store chains was 27.48 cents.³ Table 30,

¹ The expenses of the grocery wholesaler (merchant) were 12.8 per cent of net sales in 1933. This equals 9.5475 per cent of the retail price under the conditions stated above. The comparable cost figure would be therefore 25.41 plus 9.55, or 34.96, which gives the chain an advantage of 7.86.

² "Variety Store Chains and Department Store Chains," *Census of American Business, Retail Distribution*, 1933, p. 7.

³ *Ibid.*, p. 10.

TABLE 30.—OPERATING RESULTS OF (a) 23 IDENTICAL VARIETY CHAINS¹ (b) 19 IDENTICAL DEPARTMENT-STORE CHAINS²

	Variety chains		Department-store chains	
	1932	1933	1931	1932
Aggregate number of stores.....	4,713	4,759	2,562	2,525
Aggregate net sales, per cent.....	100	100	100	100
Gross margin, per cent.....	33.82	37.40	27.06	27.53
Total expense (including interest, per cent).....	32.19	32.69	30.73	33.51
Net profit or loss, per cent.....	1.63	4.71	3.45	5.29
Net other income (including interest on net worth), per cent.....	2.87	3.39	2.26	2.55
Net gain:				
Percentage of net sales.....	4.50	8.10	1.19	2.80
Percentage of net worth.....	8.08 ³	14.82	4.68	9.13
Rate of stock turn (times a year) based on average of inventories at the beginning and end of the year.....	5.12	4.76	2.87	2.51
Freight, express, postage, and truckage, per cent..			1.90	2.33

¹ *Harvard University Graduate School of Business Administration, Bull. 95, p. 5.*

² *Ibid., Bull. 94, August, 1934.*

³ Because of inadequate balance sheet data for one firm, the figure for net gain as a percentage of net worth for 1932 is based on the reports of 22 chains.

compiled from the Harvard reports, gives figures on gross margins, expenses, and other items that are perhaps somewhat more representative of the true situation. The losses suffered by the department-store chains during 1931 and 1932 clearly reflect the effects of the depression. The variety-chain figures for 1933 reflect the improved business conditions of that year. These data suggest the more favorable competitive position held by variety stores when compared with department stores. The type of merchandise sold by the former enjoys a more stable demand than that of the latter.

Table 31, compiled from a Federal Trade Commission report, gives a view of the trend in number of chains, number of stores, and gross profits of the group of chain stores investigated. The fractional stores are the result of adding the number of stores at the beginning of the year to the number at the end of the year and dividing the sum by 2.

The average gross profit for the entire group was 28.8 per cent in 1915; it fell to 23.9 per cent in 1920, increased to 27.8 per cent in 1925, then declined to 26.3 per cent in 1930. With the one exception in 1920 this average profit remained fairly stable. An examination of the table, however, reveals wide fluctuations during the period in many of the groups and likewise shows large differences in gross profits among the different kinds of chains. The gross profit of grocery chains, for example, was

only 10.8 per cent in 1915 but increased steadily until it was 22.1 per cent in 1930. Grocery and meat chains, on the other hand, started with a gross profit of 20.2 per cent in 1915; the figure for 1930 was 19.7 per cent. Gross profits of confectionery and of men's and women's ready-to-wear chains showed a marked increase. General merchandise, dry goods,

TABLE 31.—TRENDS IN CHAIN-STORE DEVELOPMENT, 1915-1930, BY KINDS OF CHAINS¹

Kinds of chains	1915			1920			1925			1930		
	(a)	(b)	(c)	(a)	(b)	(c)	(a)	(b)	(c)	(a)	(b)	(c)
Grocery.....	441½	0.8		1,840½	15.3	80	6,460½	9.9		94	1,135	22.1
Grocery and meat.....	1,750½	20.2		6,970	15.3	92	21,690	21.1		128	33,273	9.7
Meat.....				80½	18.4	45	474½	21.8		51	654	24.0
Confectionery.....				12	34.9	17	226	4.6		21	441½	52.4
Drug.....	37	33.0		366½	36.9	106	915½	4.6		166	2,217½	33.9
Tobacco.....	24	28.3		1,348½	29.2	16	1,525½	27.6		34	1,652	20.8
Variety (\$1 limit).....	1,074½	33.7		1,803½	33.6	47	2,647½	35.6		68	5,040	33.8
Variety (\$5 limit).....		37.0		8½	26.5	8	47½	27.0		14	140½	28.4
Variety (unlimited).....						3	11	26.9		5	82½	24.5
Men's ready-to-wear.....	16	28.2		65	26.3	53	269½	30.6		64	454	30.9
Women's ready-to-wear.....	10	32.		95½	29.2	56	288½	31.8		87	831	31.5
Men and women's ready-to-wear.....				6½	34.2					47	615	44.8
Men's furnishings.....				25½	30	21	110½	36.3		23	167½	34.8
Women's accessories.....	3	32.2		10½	28.7	8	65	31.6		14	122	33.7
Hats and caps.....	25	39.1		97	33.3	15	290½	42.5		16	475½	40.1
Millinery.....	26	44.9		123	42.	20	288	44.1		24	785½	44.1
Men's shoes.....	3½	24		12	29.8	10	212	28.8		1	414	33.9
Women's shoes.....	2	32.8		9½	26.4	20	146	31.4		28	463½	31.5
Men and women's shoes.....	70½	33.8	28	457	23.4	86	435½	30.1		111	2,208½	33.3
Dry goods.....				11	22.2	10	35½	26.5		14	82	18.6
Dry goods and apparel.....	90½	22		289	14.1	61	969½	26.4		7	2,004	24.8
Department store.....	13	34		29½	30.3	15	73½	33.7		24	1,050½	29.8
General merchandise.....	45½	22		84½	19.0	31	149	22.6		28	166½	17.2
Furniture.....	10	38		24	48.8	19	67	47.		23	160½	46.0
Musical instruments.....	30	39		86	43.8	15	129½	43.8		13	101½	38.7
Hardware.....	14	20.5		39	26.4	21	71	27.6		2	154	27.0
Totals.....	63	3,695	28.8	285	13,949	23.9	920	38,955	27.	1,200	64,891½	26.3

(a) Number of chains reporting.

(b) Average number of stores operated by reporting chains.

(c) Gross profit percentages.

¹ Compiled from "Chain Stores—Gross Profit and Average Sales per Store of Retail Chains," *Senate Document 178, 1933; F.T.C. Rept., 1933.*

and tobacco chains show decided declines in the trends of their gross profits during the period. It is perhaps significant that the increase in the number of stores among two of these three groups of chains was small from 1925 to 1930 while the general trend was toward large increases in numbers.

Rate of Return on Invested Capital.—The rate of return on invested capital varies considerably according to the kind of chain and according

to the number of stores in the chain. One of the reports of the Federal Trade Commission goes into considerable detail in the discussion of this situation. The report covers the years 1913, 1919, 1922, 1925, and 1927-1930, inclusive.

TABLE 32.—THE SIZE GROUP RECEIVING THE HIGHEST RATE OF RETURN ON INVESTED CAPITAL¹

Kind of chains	Number of stores	Average rate of return, per cent
Grocery.....	101 to 500	16.60
Grocery and meat.....	1,001 and over	24.60
Meat.....	26 to 50	21.90
Confectionery.....	11 to 25	14.69
Drug.....	11 to 25	16.30
Tobacco.....	101 to 500	14.82
Variety.....	1,001 and over	26.69
Women's ready-to-wear...	51 to 100	25.92
Millinery.....	51 to 100	40.62 (1930 loss, 3.41)
Men's and women's shoe..	101 to 500	14.64 (1925-1930)

¹ "Chain Stores," Federal Trade Commission, *Invested Capital and Rates of Return of Retail Chains*, Document 87, 1934.

Table 32 was compiled from this study. Drug chains and confectionery chains with 11 to 25 average stores per chain showed the highest rate of earning, for their respective groups, according to the reports returned to the Commission, during the period. The average returns were 16.30 and 14.69 per cent, respectively. The highest returns for grocery and meat chains and variety chains occurred among those operating 1,001 and more stores. Grocery chains, men's and women's shoe chains, and tobacco chains secured the highest rate of returns among those companies operating 101 to 500 stores. The rates were 16.60, 14.64, and 14.82 per cent, respectively. Meat chains operating 26 to 50 stores secured a return of 16.60 per cent, the highest for this group. Women's ready-to-wear chains and millinery chains secured the best results when operating 51 to 100 stores. The net returns for the first were 25.92 per cent; for the latter 40.62 per cent. The last group, however, suffered a loss of 3.41 per cent in 1930. The 1930 net return for each group was the lowest of any year reported and was also materially lower than the average for the entire period.

Comparative Annual Earnings of Employees.—The average annual earnings of full-time employees of independent retailers was \$1,306 in 1929 and \$947 in 1933; corresponding figures for the chains were \$1,345 and \$1,079. The average earnings per full-time employee of independent retailers decreased 27.5 per cent, while the earnings of employees of chain

stores declined only 19.8 per cent. The number of full-time employees of independent retail stores declined 33.8 per cent, while those of chains declined 17.3 per cent. Total payroll for independent stores decreased 48.9 per cent; for chain stores, 30.8 per cent. These Census figures suggest that the employees of chains fared somewhat better during the period than those of independents.¹

Determinants of Success.—The success of the chain's system of marketing depends upon a considerable amount of standardization. This applies to merchandise, policies, organization, and operation. The commodity sold should require little personal service and selling effort; it should have a high degree of repeat sales so as to permit a rapid turnover at low unit profit. The merchandise should not be so bulky as to make delivery necessary nor of such character that the average sale will be large. The store units must be densely enough located so as to make supervision and delivery from a central warehouse feasible.²

Advantages of the Chains.—There were a few exceptional business men among the independent retailers, such as J. C. Penney, Kroger, Kresge, Grant, McCrory, Walgreen, and several others who stood head and shoulders above the great mass of merchants. They developed great skill in management and in merchandising. They were also successful in training efficient assistants. Their ability was rewarded in the course of time with increased volume of sales, profits, and financial resources. They were able eventually to secure quantity discounts on purchases, to integrate wholesaling and retailing, and, in some instances, manufacturing, thereby further reducing the cost of merchandise bought. As the chains grew, size brought prestige and permitted specialization and the payment of salaries that secured the best available managerial ability. This factor has been exemplified in the scientific selection of locations, the determination of effective identifying features, the logical layout of the stores, the careful selection and control of merchandise, the training and supervision of employees, and the effective use of advertising.

E. A. Filene, in speaking of chain department stores, points out several advantages of chain systems, as follows:³

1. Their large buying power makes it possible not only by eliminating independent middlemen but by getting lower quantity prices to buy more cheaply. Often they can use the entire output of factories, relieving the manufacturer of a

¹ The Federal Trade Commission studies indicated that at the time of the inquiry chains were paying lower wages than the independents in some localities. The retail grocery code was supposed to remedy this situation. Information is not available as to what happened after the N.I.R.A. was declared unconstitutional.

² BAXTER, W. J., *Chain Store Distribution and Management*, p. 12.

³ "Billions at Stake in the Next Move of Chain Merchandisers," *Mag. of Wall Street*, pp. 384 ff., Dec. 29, 1928.

very important part of his sales expense, of some of the great losses incidental to seasonal idleness, and of the production of goods that cannot be sold at a profit. The chains are entitled to receive a share of these savings in lower prices.

2. Bigger stock turn through scientific warehousing enables them to replenish more quickly the stocks of the stores in the chain. This greater stock turn is also due to their ability to select and obtain the best locations.

3. They achieve better results through standardization of merchandise, fixtures, displays, accounting, control, personnel, policies, and the like.

4. The magnitude of their operations enables them to employ unusually expert buyers, staff men, and experts of all sorts—at an infinitesimal cost per store.

5. This larger organization offers more opportunities for promotion than small stores, which helps the chains to retain the services of really good employees.

6. The low price appeal and the concentration of their stock on most-wanted goods make it possible for chains to keep busy a larger part of the time than the small independent concerns. Ability to acquire better locations than most individual stores also helps in this respect. In the ordinary store a clerk is selling only about one-third of the time.

Most of these advantages exist in direct proportion to the volume of business. At present the larger chain-store organizations are making the most of them, and they are highly successful.

Disadvantages of the Chain Store.—The many advantages of the chains have caused some people to believe that they will eventually crowd out all other types of retail institutions. They will not, of course, unless they excel in the performance of all the marketing functions. This does not seem probable at present. They have definite limitations and disadvantages. One of the definite limitations of the chain system is its dependence on standardization. Quantity buying and mass selling tend to limit the field of selection of merchandise. The personal whims of many wealthy and important possible customers cannot be satisfied. The management must hold to the lines of merchandise that are wanted by the great mass of people so as to keep down inventories, increase stock turns, reduce sales expense, and in other ways make possible low prices to the consumer and satisfactory profits for the stockholders.

The personnel problem is a serious one for the chain-store management. The salaried manager may tend to become machine-like, impersonal in his relation to customers and to the community. He is not likely to develop the same zeal for the best interests of the company as the alert individual owner does for his own business. A chain organization, in its early stages while it is growing steadily, offers opportunities for rapid promotion to the superior employees. This condition draws many capable young men who overlook the immediate low pay, long hours, and hard work in the hope of being well remunerated through promotions. As the system approaches its full growth, the opportunities for rapid promotion to important executive positions become fewer and

more remote. This situation causes the capable young man to hesitate before casting his lot with the organization. The chain stores are attempting to meet the personnel problem in various ways, *e.g.*, through bonuses, profit sharing, stock-ownership plans, and specialized training courses.

The policies of the chains tend to limit their growth. Not all people in the country want to pay cash; some want deliveries; and others want a wider selection from which to choose. There is a prejudice on the part of a number of consumers against the chain store. Such retail outlets are regarded as inferior, and their merchandise as commonplace or sub-standard. It is felt that the chains do not enter into the life of the community, that they use unfair competitive methods, and that they may establish a monopoly. Individual stores in the chain eventually reach a sales volume where an increase in sales volume depends on a growth in population, and profits per store may actually decline.¹

The greatest limitation, however, is the increasing alertness, aggressiveness, and efficiency of the independent retailers. These merchants have learned many sound merchandising principles from the chains. They have improved the appearance of their stores and merchandise and made more effective their methods of advertising, stock control, and salesmanship. They are studying and learning the value of cooperative buying. The interest being taken in the welfare of the independent retailer by the manufacturer and the wholesaler is aiding him in securing a stronger competitive position.

Other Forms of Ownership.—Although chain stores have been developed, organized, and purchased by individual merchants, manufacturers,²

¹ Cf. Rost, O. F., *Nation's Business*, pp. 67 ff., August, 1929.

² Illustrations of chains established by manufacturers: Walk Over and Florsheim shoe companies; Browning King & Company; Brill Brothers; Wallach Brothers; A. G. Spalding & Brothers. Some manufacturers use their stores as merchandising laboratories. The objectives may be (1) more effective display; (2) testing new theories; (3) testing new merchandise; (4) checking style trends and consumer preferences; (5) to secure general information; (6) to supplement advertising. Cf. *Printers' Ink Weekly*, p. 46, Oct. 6, 1932.

The final report of the Federal Trade Commission, issued in 1935, makes the following statement: "Manufacturing chains operate over 50 per cent of the total number of stores in nine kinds of business . . . and account for over 50 per cent of the 1930 sales in nine kinds of business. . . . Over 70 per cent of the sales of manufacturing chains is represented by goods of their own manufacture in several kinds of business. In no other line of business do manufacturing chains produce more than one-third of the merchandise they sell." The kinds of business in which manufacturing chains operate extensively are confectionery, men's shoes, men's ready-to-wear, unlimited price variety, drug, grocery, grocery and meat, department store, dry goods and apparel, and millinery. Each of these manufacturing chains, except department stores, accounted for 50 per cent of the 1930 sales in the nine kinds of business. *Senate Document 4.*

wholesalers,¹ and cooperative groups, the general advantages and disadvantages are similar in all instances.

The unfavorable position into which the independent retailers are usually placed when average figures are used in comparing them with chains may not always be truly representative. Since there is a much larger percentage of small-scale, high-cost establishments among the independents than among the chains, this means that the independent wholesalers and retailers are not shown in their best light. Moreover, there are many wholesale and retail establishments that have achieved a very high degree of efficiency in performing the marketing job. A study of the average retail sales for independent and chain stores in two eastern states, for example, showed a group of independents nearly as numerous as the chains with average sales \$3,000 higher than the chain-store averages, indicating, from the volume angle at least, a high potential marketing efficiency. If selected groups of wholesale and independent retail merchants be taken it is possible to find examples of average costs that compare quite favorably with the chain system. This is particularly true of some of the voluntary chain groups.²

The Federal Trade Commission apparently believes that competition in the grocery trade will prevent the establishment of a monopoly by any individual chain, and the same is true as to the large chains in the drug group. The investigation of the Commission brought to light no violations by the chains of Section 7 of the Clayton Act; there was no evidence of agreements, conspiracies, or combinations in restraint of trade.

Organization of Chain Systems.—The typical chain-store enterprise has the usual group of stockholders, board of directors, and officers found in other corporations. Suitable locations with reference to the section of the country, the cities within the sections, and the districts, streets, and specific lot site in the city are determined, and leases on the properties wanted are secured. The task of securing a suitable location is under the direct supervision of the central office.

Each store is operated by an experienced manager, one that has received some training in the organization as a clerk, checker, cashier, or assistant manager. A group of individual stores are usually placed under the jurisdiction of a supervisor who goes around from store to store, giving instructions and advice and seeing that previously given instructions are being followed. These divisions may be organized into larger units with a district manager in charge who reports to the home office. Each district has its own warehouse, and trucks for making

¹ Illustrations of retail chains owned or sponsored by wholesalers: Chas. Broadway Rouse, Inc.; Federated Stores; I.G.A. Stores (see pp. 226 ff.).

² Cf. *Federal Trade Commission Report on Cooperative Grocery Chains*.

deliveries to the stores. Buying, with some minor exceptions, is centralized. The control system, through records and reports, is highly standardized and is efficient. The manufacturing facilities, such as bakeries, coffee-roasting plants, and packing plants, are under the manufacturing division but closely coordinated with the marketing division.

Some Adaptations of the Chain-store Idea.—There are a number of adaptations of some of the outstanding features of the chain-store idea. The two leading mail-order houses, as was noted in the preceding chapter, have adopted the chain plan rather than having made any significant adaptations. Some manufacturers, wholesalers, and large department stores have established branch stores and sponsored independent retail groups in many ways similar to the chain organizations. The most important development along this line, however, is the so-called voluntary or cooperative chain.

The Voluntary Chain.—The development commonly referred to as the voluntary or cooperative chain is a result largely of the unsatisfactory trade position of the wholesaler and the independent retailer during the period 1922–1928.¹ The corporate chains were expanding rapidly during this period, and many manufacturers were increasing their advertising pressure in the hope of creating “consumer demand” for their particular brands of merchandise. There was a decided tendency for manufacturers “to go around” the wholesaler to the retailer, and for the large-scale retailer, *i.e.*, mail-order houses, department stores, and chains, to reach back past the wholesaler to the producer. The result was that the orthodox wholesaler found his volume of sales declining or ceasing to grow at the normal and anticipated rate. Many independent retailers found themselves losing business and saw their neighbor retailers failing. The cause usually given for this situation was the development of the chain store. Much was being written about the superior merchandising methods used by this group, its scientific selection of locations, effective layout of stores, the economies of large-scale purchase, and other advantages of chain-store organization and operation. A few enterprising leaders among the wholesalers saw an opportunity to organize wholesalers and retailers into associations that could secure some of the major advantages of the chain-store plan and also retain some of the good points of the independent retail system. The plan, it was contended, would aid the sponsoring wholesalers in solving their problem of a declining market. The voluntary chain thus developed comprises a group of retailers, each of whom owns and operates his own store. The group is usually associated with a wholesaler or a

¹ The cooperative movement among retailers began in 1887. The wholesalers' cooperative activities did not begin until about thirty years later.

group of wholesalers or a manufacturer; or the retailers may cooperate in establishing their own wholesale establishment or warehouse. The group typically engages in cooperative buying and advertising. They may agree on a uniform store front and a standardized store layout and use a common name. The movement has developed to the greatest extent among grocery retailers and to a less extent among drug retailers.

The Federal Trade Commission estimated that there were 395 cooperative grocery chains in the country with an estimated membership of 53,400 retail stores. The estimated volume of business of these stores in 1929 was between \$600,000,000 and \$700,000,000. The portion of this total business that is transacted with members is probably between two-thirds and three-fourths. There were 24 cooperative drug chains with a membership of 6,041 independent retailers.

The voluntary chain movement in the United States is probably best exemplified by the Independent Grocers' Alliance. This group was organized in August, 1926. The conditions among wholesalers and retailers which promoted the organization and development of the voluntary chains in general and the I.G.A. in particular, and the solution worked out by J. F. Grimes, the moving force back of the I.G.A. plan, is stated in an interesting way in the following quotation.¹

Grimes found the average wholesale grocery salesman calling on 105 customers, selling these customers an average of \$44 a month, or selling a gross volume of approximately \$4,400 monthly. He found wholesalers with double the stocks which could be profitably carried on the volume of business they were doing. He found wholesalers with constantly decreasing sales, and increasing costs. He found wholesalers whose entire effort and thought were directed toward getting lower prices from manufacturers, then dissipating those savings in inefficient operation.

Turning to the retailer he found an equally hopeless situation. The struggling retailer, harassed by customers telling him that the chain prices were lower, was extremely price conscious. He thought that his salvation lay in being able to buy cheaper. He didn't realize that he had enough stock for two stores piled up in one store. He didn't realize that he had two clerks selling no more than one ought to sell. He was losing heavily from poor credit extension methods, paying too much rent, spreading his effort over too many different brands of similar merchandise.

Some of the voluntary chain fundamentals were: (1) smaller stocks; (2) faster turnover; (3) greater volume per salesman, both retail and wholesale; (4) a drastic reduction in both retail and wholesale overhead costs; (5) a bigger sales volume per customer by wholesalers; (6) fewer accounts for wholesale

¹ WHITMORE, EUGENE, "Grimes of the I.G.A.," *American Business*, pp. 10 f., February, 1935.

salesmen, and (7) a definite merchandising plan for retailers, actively supervised by the wholesaler through his salesmen and service employees.

* * *

Here is what Grimes visions as the grocery store of the future: A complete food market, handling fruits and vegetables, fresh meats, and a full line of rapidly moving groceries. A one-stop store where a housewife may buy everything the family eats, including bread and milk, at prices comparable to prices charged in chain stores for merchandise of similar quality. Such a store should sell for cash, should be well located, should operate a modern and thoroughgoing accounting and inventory system, and should undertake frequent drives to sell vast quantities of food products which have been advantageously purchased and supplied to them by the IGA supply depots, as he terms his wholesalers.

The I.G.A. comprises three divisions: central headquarters, wholesalers, who are often called supply depots, and retailers. Retailers and wholesalers are individually owned, but the wholesalers secured a 50 percent ownership in central headquarters in 1933.¹ There are 58 wholesaler-retailer cooperatives which operate 109 distribution points and approximately 10,000 retail stores located in 42 states. In 1929 and 1930 the Alliance developed and began using the I.G.A. label; by the beginning of 1935 approximately 600 items carried this label. The primary reason for the introduction of the label was to furnish a means for avoiding to some extent the price-cutting competition which centrally owned chain stores and independents were waging on certain nationally advertised manufacturers' brands.

Central headquarters comprises four affiliated companies: (1) The Independent Grocers' Alliance of America, an unincorporated association of retailers affiliated with the Alliance. Membership is based on a contract between the wholesaler and retailers. (2) The Independent Grocers' Alliance Distributing Company, which is an incorporated organization formed to sponsor the association of retailers into the I.G.A. This organization owns the copyright on the I.G.A. label and does the buying for the wholesalers. It is, in fact, the directing head. (3) The Wholesale Grocers, Inc., is an incorporated organization of I.G.A. wholesalers formed to acquire 50 per cent of the stock of the Independent Grocers' Alliance Distributing Company. (4) Marketing Specialists, Inc., is an incorporated organization formed by Mr. Grimes to sponsor the organization of retailers in other fields into associations.² Central headquarters provides centralized direction in the buying and advertising activities of both wholesalers and retailers and provides merchandising plans and ideas, promotes harmonious relations among members, and

¹ This summary is based on an article by Perry O. Snider, "Independent Grocers' Alliance of America," *Bull. N.A.M.T.*, November, 1934.

² The Independent Druggists' Alliance is an example.

supervises the development of new territories. Retailers have no part in the management of the wholesale business. There are four major service divisions, *viz.*, the advertising, the merchandising, the buying, and the supervision departments to aid the retailers and the wholesalers in their various capacities.

Mr. Snider summarizes the relationship between the wholesaler and retailer as follows:¹

The wholesaler usually agrees to meet the following terms: (1) enroll the retailer as an I.G.A. member; (2) supply him with a weekly merchandising bulletin called the *Whiz Bang*, and the monthly house organ, *The Grocergram*; (3) provide suitable local advertising, including newspaper, direct mail, and window display; (4) assist him in remodeling his store and suggest improvements to keep it in a modern condition; and (5) furnish the retailer with I.G.A. brand items with the understanding that the I.G.A. label merchandise will not be sold to non-member stores.

The retailer promises: (1) to use the services, insignias, and emblems furnished by the wholesaler in good faith; (2) to co-operate with the wholesaler in all activities to the best of his ability; (3) to purchase and display the standard I.G.A. sign on the front of his store and the insignias on his windows; (4) to pay a stated sum per week in advance during the life of the agreement for the advertising, buying, and other merchandising services; (5) to pay all invoices in accordance with the regular terms of the wholesaler; (6) to purchase from the wholesaler I.G.A. brand merchandise; and (7) to concentrate with the wholesaler as far as possible his purchase of grocery items handled by the wholesaler. The usual charge paid by the retailers for the advertising, buying, and other merchandising services is \$3.50 per week per retailer. Several of the wholesalers have specified that the retailer should purchase at least \$500 worth of merchandise per month from the I.G.A. wholesaler.²

The Grocery Guild.—A somewhat different kind of voluntary chain is the Grocery Guild, sponsored by Piggly Wiggly Corporation, now a subsidiary of the Kroger Grocery and Baking Company.³ The following statement from *Business Week* gives a good idea of the nature of the movement:⁴

¹ *Ibid.*

² The Red & White Stores, a cooperative chain sponsored by the S. M. Flickinger Company, was started in 1921. The chain is reported to have been operating 40,000 Red & White units in 1934. The Flickinger Company also operated a number of owned stores. The company determined, according to newspaper reports in 1934, to turn all its retail stores in New York, Pennsylvania, and Ohio over to the manager of each unit. *New York Journal of Commerce*, Nov. 3, 1934.

³ The Kroger Grocery and Baking Company is a typical corporate grocery and meat chain. The company is the second largest corporate food chain in this country (see p. 210).

⁴ From *Business Week*, pp. 8 f., Mar. 9, 1935.

Ordinarily, promoters of voluntary chains merely offer independent merchants some price advantages from mass buying plus certain sales and advertising cooperation supplied from headquarters and applied through traveling representatives. [*Business Week*, May 18, 1932, Apr. 19, 1933.]

The Grocery Guild, however, comes right into town and competes with its prospective members by establishing a de luxe retail food emporium as "mother" store. This, because of location, size, highly modern equipment, and services rendered, is expected to do a large enough volume of retail business to support all the advertising and promotional activities necessary to create business for the independent grocers that are operating stores in the same town as members of the local "chapter" of the Guild. The "mother" store also sponsors such buying and warehousing activities as are needed to give chapter members the benefit of mass buying. Wherever Piggly Wiggly stores are operating in the same area, these are permitted automatically to take advantage of Guild services.

The first Guild "mother" store is located in Cedar Rapids, Ia., where the 1933 census counted 274 food stores with a sales volume of \$3,888,000. Davenport, Ia., is next on the list and it had 245 stores with \$4,296,000 of sales. Kroger and Piggly Wiggly officials are enthusiastic over the prospects of the Guild plan, have visions of 500 to 1,000 "mother" stores and 10,000 to 20,000 Guild members.

Those familiar with the field say that the plan can work only in very large cities. They point out that the overhead imposed upon the mother store under the Guild plan will require a retail sales volume equal to, or better than, that of the average super-market, which means \$300,000 or more, and argue that in smaller towns few independents would be willing to be party to a scheme that takes such large slices of their potential sales volume at one clip.

Allied Stores Corporation.—The Allied Stores Corporation, formerly the Hahn Department Store, Inc., was started in 1928, with twenty-seven stores, operated by twenty-two firms in twenty-five different cities. Two companies were purchased in 1929; one small store was sold and another one was discontinued. Two companies operating five department stores were purchased in 1934. The name was changed in May, 1935. This is a somewhat different type of chain organization; it performs what may be called group retailing. A holding company was formed which took over the ownership and control of existing independent and apparently successful department stores.

The sales of the group while under individual ownership and operation, amounted to \$108,000,000 in 1927; net sales in 1934 amounted to \$70,828,131; in 1930 sales were \$112,323,306. The company suffered a net operating deficit of \$3,751,094 in 1933, the worst year for this group; a net operating profit of \$312,689 was secured in 1934. The plan at the time of the organization was for each store to retain its identity and be operated by its former officers. General control of the corporation was to be in the hands of a board of directors comprising the presidents of the individual firms. Central offices were established in New York City. There were five functional directors; one, each, in charge

of merchandising operations, sales promotion, market operation (central buying), fashion bureau, and store management.

The explanation given for the organization of the Hahn Corporation is about as follows:

Department stores are suffering from the competition of the chains. Entering this merger gives an isolated store a chance to become a unit, itself, in a strong chain system. The individual department store needs larger purchasing power. It tried to attain this by associating itself with resident buying offices or by joining cooperative buying associations. Both methods have accomplished much but have not been entirely satisfactory. Department store management prides itself on the individualism of its methods, particularly its merchandising. A group of department stores has a better chance to use special ideas, to feature its own brands, and to control exclusive agencies than has a single store.¹

Summary.—The chain store is the most recent development in mass retailing. The corporate chain operates its multiple retail units under central ownership and management. The voluntary or cooperative chain retains individual ownership of the retail stores but employs a considerable degree of centralized control over buying, advertising, and store operation. The plan is designed to secure economies through integration, large-scale buying, and standardization in operation.

There are definite limitations to the use of this type of organization. Standardization as to merchandise, services, location, and price necessarily limits the appeal to certain groups of consumers. As the chain adds new stores and expands over wide geographical districts, the problems of securing and maintaining an adequate personnel and of exercising effective control over costs, prices, profits, and public relations increase greatly. The chains have incurred the enmity of the independent wholesaler, retailer, and some manufacturers. These have used their influence to create unfavorable public opinion toward the chains. This antagonism is being exemplified through legislation placing heavy taxes and other forms of restrictions on the activities of the chains.

While it is evident that chains have used poor judgment in some of their buying and selling practices, *e.g.*, in using undue pressure to secure unreasonably large discounts and allowances from manufacturers and in drastically cutting prices on certain lines and brands of merchandise which were used as "leaders," it is also evident that they furnish an economical means for placing many lines of merchandise in the hands of the consumer. They have done much to develop and to put into practice better buying and selling methods. They have expanded chiefly in the kinds of retail business most adapted to their mode of operation. They have secured their important position in these fields of

¹ MURPHY, J. A., "What Is behind the Hahn Merger," *Sales Management and Advertisers' Weekly*, pp. 724 ff., Dec. 22, 1928.

retailing, not through anti-social and uneconomical practices but largely on merit. The best solution for the so-called chain-store menace is not discriminatory legislation and taxation but more effective methods of operation on the part of the independent retailer. This may be secured as an individual merchant or in cooperation with others in the form of the so-called voluntary chain. The solution is, therefore, better management rather than taxation and incrimination which is unlikely to aid materially the independent but will, in all probability, force the consumer to pay higher prices.

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"Special Discounts and Allowances to Chain and Independent Distributors—Grocery Trade," *Senate Document 89.*

"Service Features in Chain Stores," *Senate Document 91.*

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"Prices and Margins of Chain and Independent Distributors, Washington, D.C.—Drug," *Senate Document 98.*

"Miscellaneous Financial Results of Retail Chains," *Senate Document 99.*

"State Distribution of Chain Stores," *Senate Document 130.*

Seventy-fourth Congress, First Session.

"Final Report on the Chain Store Investigation," *Senate Document 4, 1935.*

This report contains a brief summary of the major findings published in the preceding reports and the recommendations of the Commission.

Questions for Discussion

1. What is a chain-store system? What are the different kinds of chains? (State the bases for your classifications.) How important are chains—measured on the basis of proportion of total retail business secured? (Consult Census Reports and Federal Trade Commission reports.)
2. What is the origin of the chain store? Of the self-service store?
3. How do you account for the fact that the chains do a much larger portion of the business in some lines of retailing than in others? What lines seem to be favored by chain managements?
4. "There are two influences at work, however, which may serve to check the rapid expansion of the chain in the future." What are they? How potent do you think they are?

5. "The most important of all advantages which develop from chain organizations are those which come through integration." What is meant by integration as used here? Show how and why it constitutes an advantage. Enumerate other advantages of the chains.

6. Why has there developed such a strong popular feeling against the chains?

7. Try to find out what the following groups think of chain stores, and why they think as they do: (a) consumers in general, (b) students, (c) professors, (d) professional people, (e) laborers, (f) housewives, (g) retailers, (h) wholesalers, (i) manufacturers.

8. Do chains give short weights and measures? Do they send more money out of the community and pay lower wages and taxes than competing independent stores? Are their employees less friendly to patrons?

9. How do chain-store (a) costs, (b) prices, (c) wages, (d) quality of merchandise compare with those of independents? How do you account for the differences?

10. Why have the chains developed their own brands for many lines of merchandise? What lines have rather generally been selected for their own brands?

11. Do you believe there is a possibility of the chains securing a monopoly in the food-store field? Drug store? Variety store? Justify your answers.

12. "As with other large-scale organizations, a chief disadvantage of the chain store is the personnel problem." Why is this a disadvantage? What can be and is being done about it?

13. Have the chain systems been a financial success? Break this question down for discussion, showing to what extent financial success has been attained, what chains have not been successful, and why.

14. How do you account for the rapid growth of the voluntary chains? To what extent does this movement furnish a solution of the problems of the wholesaler and independent retailer?

Assignment

- Problem 1, p. 62. Everman Stores Company—Location and Control.
- Problem 2, p. 83. Langdon Stores Company—Chain Expansion Policies.
- Problem 3, p. 85. National Hardware Stores, Inc.—Expansion Policies.
- Problem 1, p. 552. Lincoln Stores Company—Private Brands.
- Problem 1, p. 19. A-Quality Stores Corporation—Substitution.
- Problem 3, p. 726. National Biscuit Company—Sales to Chains.

CHAPTER VIII

MARKETING METHODS

Purpose of this chapter: To show how the elements of our marketing structure are combined and used to form the "channels of distribution."

We analyzed, in the last four chapters, the nature of the services that are found necessary for the effective marketing of economic goods and examined the characteristic features of the functionaries that perform the various services. Chart V presents in a summarized form the elements of our marketing organization.

The producers of	The marketing functionaries		The consumers
	Wholesale	Retail	
a. Natural products	a. Wholesale merchants of various kinds	a. Small-scale independent merchant	a. The ultimate consumer
b. Agricultural products	b. Agents of various kinds	b. Large-scale merchants	b. Industrial consumer
c. Manufactured products	c. Facilitating wholesale marketing institutions of various kinds	(1) Department stores (2) Mail-order houses (3) Chain stores	c. Institutional consumer
d. Services		c. Voluntary chains d. Consumer cooperatives e. Utility-operated stores f. Commissaries g. Retailers of services h. Others	d. Governmental units e. Others

Business enterprises that facilitate the performance of the marketing process, *e.g.*, transportation and communication firms, insurance, banking, and financing companies, government agencies, etc.

CHART V.—The Marketing Organisation.

The functionaries available to the producers and the consumers are indicated; the reader is reminded, however, that no particular combina-

tion is here indicated or even suggested. The producer may elect to use one or more or he may use none, choosing to "sell direct."

Our task now is to discover *what* combinations of functionaries are employed, and under what conditions the different combinations are used in any given instance. The term *marketing methods* as used here means the *use* of any given combination of functionaries in the marketing of merchandise, materials, produce, and services. The distinguishing feature of a given *method* of marketing is the utilization of a *particular grouping* of agents and merchants.

The major objective of the producer is to get his goods into the hands of the final users at a price that will cover the costs involved and give him a reasonable profit. Since the amount of the profit he will receive in a competitive market is determined to a considerable extent by the costs, he is anxious to use the method that allows the lowest cost compatible with the necessary amount and quality of service rendered. The user is concerned with procuring the desired amount and quality of goods at as low a price as possible. This condition generates a keen competitive situation. The buyer "shops around" from place to place seeking lower prices or better quality; the producers and the merchants are constantly seeking new methods in their attempts to lower costs and to meet the demands of the buyers for lower prices. The producer or the merchant who makes the mistake of thinking he has found the ultimate solution is likely to find himself without buyers. At one time, for example, grocery products, hardware, dry goods, drug products, and later electrical supplies passed from the *producer* to the *wholesaler*, to the *retailer*, and finally to the *consumer*. The use of this combination of functionaries is generally referred to as the orthodox or conventional¹ method of marketing. These four groups of merchandise were known as the "jobbing" lines because of the prominent position in the marketing scheme held by the wholesaler who was commonly known as a "jobber."

The Changing Character of Our Marketing Methods.—Marketing methods in the United States, and generally throughout the civilized world, are in a continual state of flux. As long as economic, cultural, and political environments maintain their dynamic character, we shall have

¹ The title to merchandise and the merchandise itself do not always pass along the same channel. Consider, as an illustration, wheat grown in Kansas. It may pass from the producer to a buyer in Kansas City. So far title and product probably moved simultaneously along the same channel. Title from this point, however, may pass from the merchant in Kansas City through a commission man in Chicago, by way of the board of trade to an exporter in New York, or a foreign importer in Liverpool, to a foreign miller on the continent. The product, on the other hand, may pass from an elevator in Kansas City by way of a railway to an elevator on the Gulf of Mexico, thence by steamer to an elevator in some city on the coast of Europe, and then by rail to a miller in an interior city.

no fixed or static marketing organization. New products, the result of invention and discovery, and new ideas resulting from our changing mode of living are continually appearing. The producer, the consumer, and the functionaries are accustomed to change and expect it. Objection to the changes is usually confined to the small minority that has some form of vested interest in the old method that is adversely affected by the new.

Producers and large-scale buyers are constantly trying out different combinations in their efforts to lower costs, increase profits, and improve the quality of service. Some producers sell direct to the ultimate users, others sell to retailers who sell to the consumer, while still others use many different combinations of the various kinds of merchants and agents. Industries often use different methods, firms in the same industry quite frequently use unlike methods, while the same company may sell part of its output through one set-up of middlemen and another part directly or through a different organization of market functionaries. It is evident that *market channels*

... cross, merge, and separate again into diverse ways, in different industries, to meet the particular needs as they are discovered. It is not practicable or desirable that there shall be any distinct segregation of distributive functions along uniform or precise lines. It is desirable, however, that the functions shall be simplified where possible and adapted to changing conditions, for these changed conditions are the outgrowth of fundamental economic changes.¹

The immediate cause of all these changes is the intense competition among producers and merchants who are attempting to improve their trade position. The inauguration of these changes, however, frequently meets serious opposition. Wholesalers refuse to buy from certain manufacturers because the producers sell directly to some retailers. Independent retailers boycott manufacturers because they sell to chain stores and mail-order houses; trade associations attempt in various ways to prevent changes.² More recently, attempts to prevent these changes, and, in a few instances, to return to former methods were made through provisions in some of the codes. The changes, nevertheless, in the great majority of cases, have gone on. They have continued because they were an essential part of the solution of the problems that arose as a result of the basic changes constantly taking place in our commercial, industrial, social, and political life.

Our change from a household economy to a factory system had far-reaching effects. The wage system brought an increased money income; there is an ever-increasing concentration of people in the cities; our

¹ "Methods of Distribution," National Distribution Conference, *Report of Committee V*, p. 5.

² *Ibid.*, p. 36.

educational system has decreased illiteracy; the radio, newspaper, and national magazine make large-scale advertising possible; and improvements in transportation and communication facilities have tended to knit large sections of the world into commercial entities. All of these factors have tended to raise the standard of living and thereby created a demand for larger quantities and varieties of merchandise and services.

Present Status.—Alert commercial and industrial leaders are making heroic attempts to keep their business machines abreast of the times. They are trying to determine how much of the marketing process should be undertaken by the manufacturer, the wholesaler, the retailer, and the various agents. They want to know when integration should and should not be used. The consumer has ceased to be a passive onlooker. He is demanding that each producer, merchant, and agent justify his position in the marketing system. The following quotation presents an interesting picture of the state of affairs during the late 1920's with reference to marketing methods.¹

Within the last few months business has witnessed changes in our distributing system on a scale impossible even a few years ago. The largest manufacturer of proprietary medicines has consolidated in a holding company with the largest chain of drug stores in the world without exciting more than casual notice. A huge producer has affiliated himself with fifteen wholesale houses, and further integration with a group of retailers is projected. Yet, as late as 1902, a proposed union of several large wholesale hardware concerns met with a veritable storm of protest, both in the popular and the trade press. It was finally abandoned to the relief of all.

No period in the history of business has brought forth greater uncertainty over methods of distribution than the present. Never have manufacturers been confronted with such a variety of routes leading to the consumer, one of which they must choose, but none of which is free from hazards. New channels are attractive, but not thoroughly tried; old ones are strewn with failures.

Surveying the maze which constitutes our system of distribution, such a thing as a trend, or a dominant movement, is scarcely discernible. A rapid succession of changes at first seems to be its only plan. Today a manufacturer is selling through wholesalers and jobbers; tomorrow he is selling direct to the retailer. Now he refuses to sell to mail-order houses; again, he sells to chain stores only. Still others refuse to deal with any save the independent dealer.

Retailers are manufacturing. Manufacturers are retailing. Both are wholesaling. Wholesalers are manufacturing, and buying retail outlets. Manufacturers buy wholesalers, who in turn control retail establishments. Retailers buy cooperatively. There are buying clubs, cooperative wholesalers, cooperative associations, resident buyers, service corporations, guilds, pools, and groups. Tomorrow there will be others.

¹ NORTH, H. C., *Sales Management and Advertisers' Weekly*, pp. 539 ff., Dec. 1, 1928.

There are enthusiasts for all. There are enemies for all. Emotion is intense; opinions are numerous; dispassionate judgment is uncommon. In no other phase of our economic life have feelings and prejudice clouded the facts as they have those of distribution. Politics, fanaticism, and class interest obscure none too obvious issues.

But if observed from a sufficient distance, through dry eyes, the labyrinth is not without a plan. Each stream in the ever shifting net-work ultimately leads to the same goal, the consumer. However, it may be diverted, its general direction is always the same.

All the commotion is caused by somebody trying to disentangle himself from the maze, and cut a shorter and a better channel between the producer and the consumer.

The state of confusion was greatly increased during the 1930-1933 period of the depression. The bitter competition, which only a severe business depression can generate, brought many questionable practices to public attention. The solution proposed was the code system. This device succeeded in removing or in mitigating some abuses but created and promoted others. The weaknesses of the Code plan of solution were recognized before the N.I.R.A. was declared unconstitutional.

The argument concerning methods of marketing centers chiefly around the questions of "Who may sell what?" "When can he sell?" "To whom may he sell?" and "What can he charge for his services or merchandise?" Attempts have been made, for example, to prevent drug stores from selling non-drug items. Ohio druggists are reported to have tried to get the State Health Department to stop the sale of drugs and packaged medicines in non-drug outlets. Wholesale and retail druggists of Oregon and Washington voted to stop all drug sales to 5 cents-to-a-dollar variety stores. This restrictive attitude on the part of the druggists is interesting in view of the facts revealed by the *Census of Distribution*. A large proportion of the drug stores in the country, 34,844 in number, had fountains. Sixty per cent of the total number secured only 43.8 per cent of their volume of business from strictly drug-store lines; the remaining 56.2 per cent represented sales of beverages, tobacco products, candy, food, stationery, electrical goods, toys, novelties, and other goods that at one time were sold exclusively by retailers in those lines. Some druggists discussed, at a recent meeting, plans to add paints, varnishes, lacquers, and fast-moving household and hardware items. The U.S. Department of Commerce found in its St. Louis Drug Store Survey that 31.8 per cent of the total net profit of the drug store was derived from the fountain, 21.3 per cent from the prescriptions department, 20.2 per cent from the packaged-medicines department, 18.3 per cent from the tobacco-products department, 14.2 per cent from the hospital-supplies department, 8.6 per cent from commissions, 2.5 per

cent from the confectionery department, and 2.2 per cent from the sale of newspapers and magazines. These figures indicate that the typical modern drug store has become a form of department store comprising eight or more divisions, with the two drug departments, *i.e.*, prescriptions and packaged medicines, furnishing only 41.5 per cent of the total net profits.¹

Merchants and producers in other lines are attempting to guide the flow of goods through particular combinations of functionaries. Laws and code provisions are the devices most frequently used in the effort to attain the objective. The impediments that restrict the free use of methods of marketing may be classified under two headings, *viz.*, those that impede the flow of goods themselves and those that restrict the activities of the functionaries.

Impediments to the Flow of Goods.—The movement of goods may be greatly restricted through discriminatory taxation. Thus the dairy interests in a number of states have succeeded in getting laws passed by their legislatures that put such a high tax on oleomargarine that the sale of the product in those states virtually ceased. There was little or no expectation that this tax would produce any appreciable amount of revenue. The major purpose was to eliminate the competitor of a favored product.² Health laws have been used, on occasion, to prevent the entrance into a state or a country of competing products. The use of tariffs, quotas, and embargoes as restrictive devices in international trade are, no doubt, familiar to the student.

Impediments to the Activities of the Functionaries.—This class of restrictions comprises (1) discriminatory taxes on certain classes of sellers, *e.g.*, on hucksters, peddlers, house-to-house sellers, chain stores, and others.³ Such taxes are used in an attempt to preserve the existing

¹ The sale of drugs in France constitutes a monopoly reserved to pharmacists and chemists who are qualified under French laws to trade therein. No drugs may be obtained except at drug stores which are subjected to government control. The wholesalers of prepared drugs must be qualified druggists. News item, *New York Journal of Commerce*, Apr. 9, 1935.

² The law in Wisconsin, which became effective in 1932, placed a \$1,000 tax on the manufacturer of oleomargarine, one of \$500 on the wholesaler, and \$25 on the retailer, and smaller license fees on hotels, restaurants, boarding houses, and bakeries. The consumer paid a tax of 6 cents a pound. In 1929-1930 the sales of butter substitutes in Wisconsin amounted to 8,520,000 pounds; at the time butter was selling at 40 cents a pound retail and oleomargarine at 25 cents. Before the passage of the law there were 63 oleomargarine wholesalers and more than 5,000 retailers in Wisconsin. At the end of 1934 there were only three retailers in the state, and bootlegging activities had developed. Higher prices for butter will make it possible for dealers to pay the taxes and again sell oleomargarine. To prevent this, the 1935 legislature raised the tax to 15 cents a pound.

³ This topic is discussed in Chap. XX.

order and to discourage competition. (2) Regulations that attempt to control the "distribution differentials."

Distribution Differentials.—Much of the discussion centers around the problems of discounts and margins. Large-scale buyers feel that they deserve substantial discounts because of their large volume purchases. Small-scale operators feel that the large discounts received by the chains, department stores, and mail-order houses place the small retailer at a great disadvantage. Wholesalers object to the manufacturer selling direct to the large-scale retailers, and to the large-scale retailers performing some or all of the services commonly regarded as wholesaling functions. The brokers and commission men quote their grievances at being left out in the general movement toward integration. Long-established functionaries, such as the brokers, wholesalers proper, and small independent retailers, tend to resist the development of novel or special functionaries of marketing. Thus the wagon jobber, drop shipper, and other limited service wholesalers were regarded somewhat as interlopers. The feeling of the independents toward the coming of the large-scale retailers has been mentioned.

The solution proposed by those attempting to preserve the old-line functionaries is to establish margins, between the manufacturer and the wholesaler and between the wholesaler and the retailer, that will permit each to pay his costs and enjoy a profit. The integrated companies must pay the same margins or be taxed to compensate so they cannot sell to the consumer at a lower price than the non-integrated group. The establishment of resale price maintenance and uniform retail prices within the same market area is part of the plan.¹ It is only fair to state that the orthodox group feels that the newer groups do not have the real economical advantages claimed. They contend that the mass retailers secure quantity discounts and other forms of allowances that are not warranted. They are opposed to the classifications of customers of manufacturers which give the large-scale retailers a purchasing advantage over the small independent retailer.

Disorganization and confusion in the methods of marketing may be caused, it is true, by unfair and unwarranted discounts and allowances. Some functionaries who handle a portion of the supply of a given line of merchandise may be operating under restrictions while other functionaries may operate without such handicaps. Eighty per cent of some goods goes through wholesalers, while 20 per cent goes direct; in other instances more than 50 per cent goes direct, while the remainder goes through wholesalers. Such conditions quite frequently promote unequal competition.

¹ Ten states have enacted laws permitting manufacturers to enter into contracts with merchants to set resale prices. Not all manufacturers or merchants, however, take advantage of the laws.

The chains, for example, were accused of securing low prices through threats and coercion and the operation of brokerage and commission agencies. The Federal Trade Commission reported that charges were made that, if a manufacturer refused to grant a chain a special concession in price, the chain threatened to buy the desired merchandise elsewhere, to manufacture its own, or conduct its stores so as to discourage the sale of the manufacturer's products therein. There are no laws at present forcing a merchant to buy from any particular source or through a given functionary. There is no law that prevents integration, such as occurs when a merchant enters the manufacturing field. The controversy might be simplified, especially with reference to the large-scale retailers, if the following questions were agreed upon.

1. Is it socially or economically undesirable for a retail or a wholesale merchant to engage in manufacturing?
2. Is it undesirable for either of the foregoing to engage in brokerage transactions?
3. Is it undesirable for a retail merchant to engage in wholesaling?
4. Is it undesirable for a retail merchant to buy his merchandise at as low a price as practicable?
5. Is any one of the following undesirable from a marketing viewpoint: *integration, large-scale operation, bigness, or monopoly*?
6. Should the consumer be forced to pay the high prices necessary to maintain a rigid or static combination of marketing functionaries?

Factors That Determine the Choice of a Method.—Changes in marketing methods obviously should not be made merely for the sake of changing or of being different. The major problem confronting the executive is the determination of the *best method* to use for his particular firm and product, under the conditions that exist or will exist during the immediate future. The proper method to use can be scientifically determined only after the controlling factors have been isolated and each carefully evaluated as to its effect upon the combination.

There are a few major factors that must be considered in selecting a method for the marketing of any given product or service: (1) the character of the demand for the product or service; (2) the character of the product and of the method of production; (3) the relative location of producers and users; (4) and the nature of the available marketing functionaries and their willingness and ability to perform the necessary marketing services. These factors exert a controlling influence on the results secured in the use of any method of distribution.

The characteristics of the demand, of the product or service, and of the producer, his location, and his methods of production determine the services to be performed in marketing a specific good; the amount and quality of the services to be performed determine the character of the policies, organizations, and methods best suited to perform the services.

A method of analysis that centers attention on the pertinent elements and that brings out the limiting factors is indicated in these three questions.

*A Method of Analysis.*¹—1. How does the character of the demand influence the marketing procedure and, consequently, the costs and the profits?

2. How do the character of the product, the producer, the method of production, and the location of the producing units affect the marketing of the product?

3. How well does the existing marketing structure meet the needs for marketing this product or service?

Characteristics of the Demand.—In Chaps. II and III some of the more significant phases of demand were discussed. It is only necessary, consequently, to suggest at this point the relationship existing between the nature of the demand and of marketing methods that affects the efficiency of marketing practice.

The volume of sales, costs of selling, net profit, and the services to be supplied are materially affected by the nature of the demand. Thus if the product is sold in large quantities to industries, the unit of sales will probably be larger and the costs of selling lower than in selling the same or similar products to the ultimate consumer. The buyer for the manufacturing concern will quite likely have as much and as accurate market information—with reference to the supply available, quality of product, market price, terms of sale—as the seller; whereas the typical consumer is not so familiar with marketing facts and conditions. The location of the users of the product with reference to the place of production vitally affects the services required and the costs involved. If the users are widely scattered throughout an area remote from the place of production, the transportation, storage, and finance functions become very important elements of cost, more so than when the users are concentrated in small areas or are collected near the place of production. A product that is in demand continually throughout the year is usually bought at frequent intervals, tends to remain in popular favor year after year, sells at a lower unit price, and has a lower marketing cost than a product only one unit of which is bought in a generation for the use of the family rather than for an individual or a product that has an intermittent or a definite seasonal demand. The amount of knowledge or degree of understanding concerning the product, on the part of the users, affects the volume of sales and the costs of selling. A new and little-understood product must be described and explained to the possible buyers. This means large expenditures for advertising, salesmanship, demonstration, sampling, and other educational and sales-promotion efforts.

¹ This plan of analysis is further developed at the end of this chapter and is exemplified in Part III.

The price policy of the selling firm is influenced by the degree of elasticity of demand. Reducing prices on a product whose demand is inelastic will not materially increase unit sales but will reduce dollar receipts and profits. The reduction in the price of a product with an elastic demand may bring about an increase in both unit and dollar sales and in total net profits. The price and the volume of sales, as well as the cost of marketing and the profit, of a particular product may be greatly affected by the demand for some other product. Thus the demand for certain fruits and prepared breakfast foods creates a demand for sugar, syrup, milk, cream, and butter. The use of the automobile creates a demand for gasoline, rubber, glass, and certain metals; the radio, electrical refrigerator, and washing machine call for electricity. The ease with which an article of merchandise is sold often depends upon how it is to be used, *i.e.*, whether it is to be used to produce more goods and services, to be sold at a profit, or to satisfy some personal desire of the purchaser. If it is to be used for the last purpose, then the buying habits of the user are important factors to consider.¹

Characteristics of the Product.—Another set of factors that affect the marketing practice centers around the product. The degree of perishability dictates the extent of the market area and the type of transportation and storage facilities needed, and it raises problems of selecting suitable containers and controlling market risks. It is evident that costs, prices, gross margins, rates of turnover, and profits are dependent upon how the management meets the problems presented by this feature of the product.

The degree of bulkiness—the ratio of volume and weight to value—serves also to limit the market area. Products of highly concentrated value, such as precious metals and stones, move freely throughout the world. Wheat, silk, copper, petroleum, and certain manufactured products have wide markets. Building stone, common bricks, coal, iron ore, and lumber, on the other hand, must be sold nearer the places of extraction and production. The cost of transportation very definitely limits the market area for such merchandise.

The qualities of a product that make possible grading according to established standards are important. Some products, such as wheat, corn, cotton, silk, and lard, lend themselves to grading. These products may be bought and sold by grades and samples on organized exchanges. Other products, such as live stock, wool, and lumber, are graded according to trade standards, yet their qualities are such as to require close inspection. Machine-manufactured products tend to be standardized and so may be bought and sold on the basis of description and sample. There is a uniformity in size and quality that reduces the time required for inspection.

¹ Cf. Chap. III.

tion by the purchaser. Handmade products lack this uniformity; consequently, each article has to be individually inspected, which means more time and greater costs in performing the marketing process.

Method of Production.—The large-scale producer who operates on a decreasing cost basis¹ frequently uses aggressive marketing methods to increase his volume of sales. National advertising, integration, mergers, price concessions, and even unfair practices are used to secure mass distribution which is necessary to keep mass production going at an economical rate. The large-scale producer looks for national and international markets; the small-scale producer, unless he has a monopoly or produces a specialty, is usually limited to a local or sectional market.

The greater the length of the production period, the higher the costs of marketing, because larger inventories of raw materials, goods in process, and finished goods are necessary. This condition increases the risks of loss from a fall in price and from changes in style and design. If the firm is manufacturing to order on specifications, these risks are greatly reduced.

The relation of the product to other goods, i.e., whether it is the principal product, a by-product, or is produced under a condition of joint costs, quite frequently controls the marketing policies adopted by the management. The large meat packers and petroleum refiners are among the manufacturers that produce under joint costs and have a large number of by-products.

Goods, such as wheat, live-stock, poultry and dairy products, groceries, hardware, certain types of clothing, and dry goods, produced by a large number of small-scale operators, require an elaborate marketing organization for economically assembling the merchandise from the various producers. The goods sold to a large number of small users require an elaborate marketing organization comprising wholesalers, retailers, brokers, commission men, and other marketing functionaries to distribute them among the consumers.

The influence of the characteristics of the method of production is illustrated in the change that took place in marketing cotton when the large-scale plantation system of production, based on slave labor, was

¹ In some industries, as the volume of production increases, the cost of production per unit decreases. Railway transportation, automobile, tire, and shoe manufacturing are good examples. Apparently a large volume of business for a marketing functionary does not tend to reduce costs to the extent that it does in production; e.g., the optimum-size grocery store is estimated to do an annual business of \$50,000, while the most efficient drug store does an annual business of \$25,000. The optimum size depends upon the location, to a considerable extent, in any given instance. Thus \$25,000 might be the optimum size for a drug store located in a town of 5,000 or 10,000 but be a failure in the "down-town" section of a city of 500,000 population.

replaced by the small-unit independent farmer system following the Civil War.

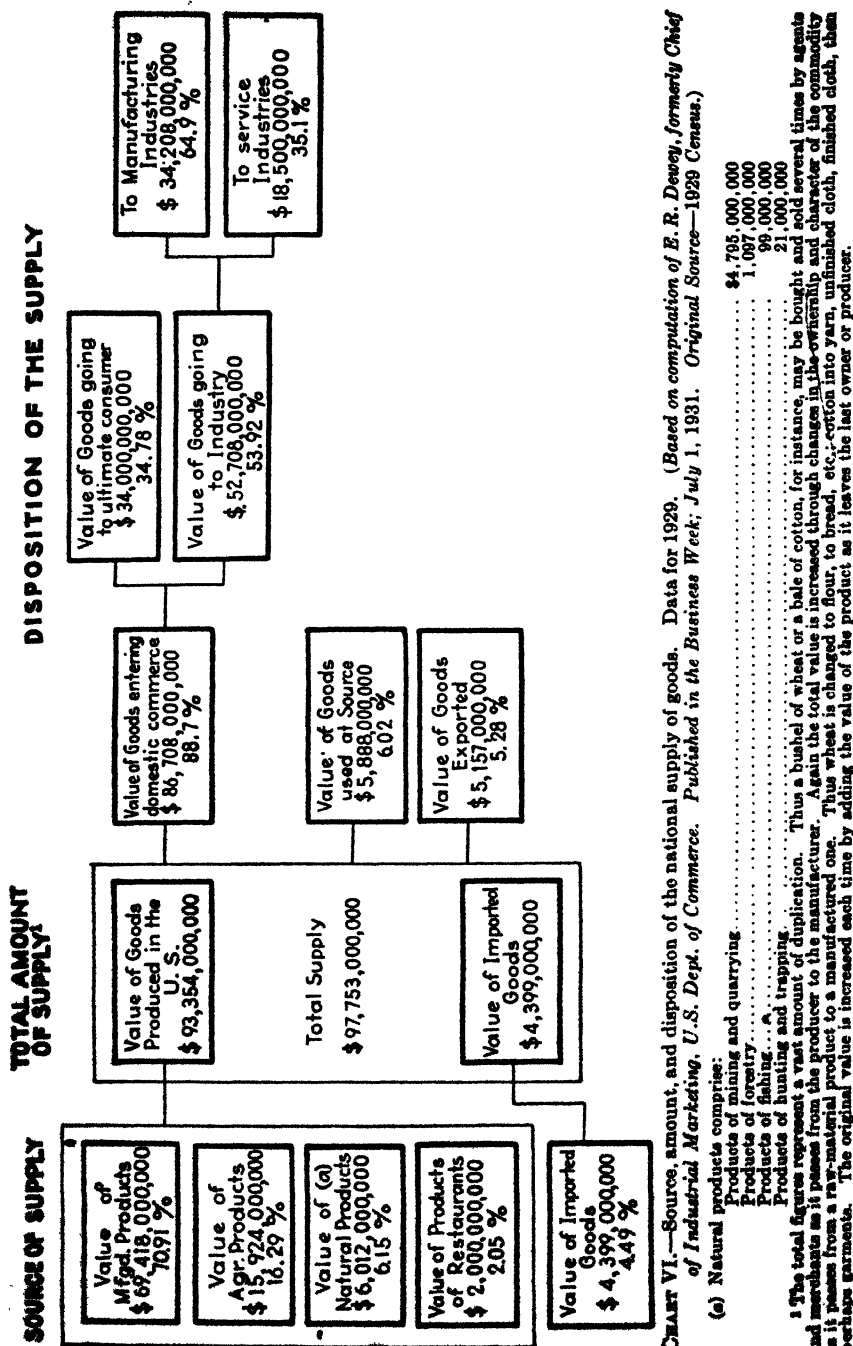
Marketing procedure was relatively simple under the plantation system with its own gins, stores, and large unit-production credit machinery. The independent farmer system ushered in small-scale production, the small country town bank, hardware and grocery stores, the independent gin companies, the cotton yard, and various institutions for advancing production and marketing credit.

During the regime of the plantation system cotton was sold in large quantities direct from the plantation to exporters and to large mills in the North and in Europe. Under the present system of production much of the cotton is sold in the local market in small lots to local buyers who have advanced credit to the small producers and to buyers sent out by the large firms located in the central markets and at the export centers and, in a few instances, direct to representatives of cotton mills. The mills seem, however, to prefer to buy from some merchant who has assembled his cotton into even running lots as to grade, staple, and general qualities.

Some industries tend to centralize in certain states and cities; thus we find the largest volume of automobiles produced in Michigan, especially in Detroit. Tires are manufactured in Akron, while steel is produced in Pittsburgh and in the Calumet district of northwestern Indiana. The location of some manufacturing industries is determined by the location of natural resources used as raw materials and by transportation facilities. Other industries are located near the more important markets for their products. There is a tendency at the present time for many industries to become more decentralized than formerly. Thus manufacturing branches are established in different sections of the country and in foreign countries. These practices tend to reduce transportation costs on the finished product and to get around the tariff barriers in foreign countries.

Character of the Channels of Distribution.—Chart VI indicates the sources of the major classifications of goods and where the demand for them lies. It is the task of the marketing functionaries to provide an economical method for equalizing the supply and the demand.

The characteristics of the demand, the product, and the method of production determine, in the long run, the organization used and practices followed in marketing. For relatively short-run periods, however, the marketing methods used may be determined largely by common practice, by tradition, or by what is immediately available. The choice of a method for distributing goods should be guided by the relative costs involved for performing the amount and quality of services needed. It is the function of the management to determine, by a careful considera-



tion of the facts, what is the best method under the conditions; what would be the best plan under an ideal set of conditions; and what are the possibilities of reaching the ideal conditions. Consideration should be given to the marketing agencies available and to ways of combining them into an organization or system that will give the lowest costs compatible with the amount and quality of services needed or desired.

J. G. Pollard, Jr., suggests a detailed list of factors that should be considered in choosing a method of marketing.¹

FACTORS TO CONSIDER IN SELECTING A METHOD OF MARKETING

1. Volume of sales.
2. Average size of order.
3. Frequency of order.
4. Regularity of demand.
5. Frequency of repeat sales without solicitation.
6. Newness of product on the market.
7. Rapidity of changes in design.
8. Relative awareness of value of product.
9. Need of promptness in delivery.
10. Density of the market with respect to plants.
11. Need of personal acquaintanceship with buyers.
12. Attitude of users of product.
13. Technical knowledge required in making the sale, installing the product, or demonstrating the use of a product.
14. Repair service.
15. Degree of standardization for all uses.
16. Relative necessity of product.
17. Weight of product relative to price.
18. Degree to which product can be sold by advertising.
19. The type of persons influencing purchases.
20. Attitude of distributors.

It is just as important, however, to determine the amount of emphasis to give each factor in any specific instance as it is to determine the factors themselves.²

Methods of Marketing.—There are three major methods of marketing. The *direct* method, in which the producer of the goods deals directly

¹ "Twenty Points to Consider in Selecting a Distribution Policy," *Printers' Ink Weekly*, pp. 153 ff., June 21, 1928.

² Under the heading, "Factors Determining Choice of Trade Channel," *Report of Committee V*, National Distribution Conference, the following list was presented: volume of business, perishability of the product, whether or not an article is a staple or a specialty, number of retail outlets, average size of retail order, whether manufacturer puts out a single product or a line of goods, whether goods are nationally advertised, whether jobbers give proper cooperation, whether special training or technical knowledge is necessary on the part of the salesmen, whether goods are standardized or made according to specification, whether production is seasonal, need of financing, distance from market, custom, whether functions can be simplified.

with the final buyer without the assistance of intermediaries; the *indirect* method, in which one or more middlemen aid in negotiating the sale and in passing the goods and the title along from the producer to the final buyer; and the *cooperative* method, in which producers, merchants, or users organize associations for the purpose of looking after all or a portion of the marketing interests of the members.

The Direct Method. *Used by the Farmer.*—This method of marketing is used more or less by producers of practically all kinds of products and services. Farmers who live near cities frequently sell their fruit, vegetables, and, less frequently, their dairy and poultry products directly to the housewife. The produce may be peddled from house to house or sold in a public market place to which the consumers come. Some produce, especially eggs, may be sold by means of mail solicitation and the deliveries made by parcel post. An increasing amount of agricultural produce is being sold directly to the consumer from roadside stands erected in the farmers' front yards. The widespread use of the automobile by the urban population is tending, in such instances, to transfer the performance of the delivery function from the producer to the consumer.

The direct method of marketing is rapid, and the consumer receives fresh produce, possibly at a lower price than he can purchase it from his retailer. The variety from which to choose and the stability of supply, however, are not so satisfactory as the typical retailer furnishes. When the consumer goes to the public market or to the roadside stand, much time is consumed and he must pay cash and assume the responsibility of getting the produce home.

Selling agricultural products by mail has not proved so popular as was anticipated. The farmer has difficulty in finding customers who are prompt in making payments. The customer encounters annoyances in his attempt to secure adjustments on account of breakage and damage. The difficulty in determining the market price, because of differences in time, place, qualities, and quantities, is a serious obstacle to selling directly by mail. The appearance of the chain grocery store with its relatively low prices on farm produce probably had a deterring effect upon the possible growth of the direct method of selling agricultural products. Many consumers are convinced that they can "do just as well" at the chain store or at the fruit store.

An increasing quantity of agricultural goods to be used as raw materials is being sold directly to manufacturers. Thus live stock is sold directly to the packers, grain to mills, fruits and vegetables to canning companies, milk and cream to creameries, condensereries, and butter and cheese factories. The method may be preferable when the manufacturing plant is located near the farmer so that deliveries in

relatively small lots can be made economically; when the farmer produces in large enough quantities to ship in carload lots, if the distance between farm and factory is too great for delivery by truck; and when the manufacturer sends his buyers to the farms to contract for the goods. The manufacturer in the last instance is really performing that part of the buying function usually performed by an independent local shipper.

Used by the Seller of Services and Natural Products.—The typical method used in selling services and natural products is from producer direct to user. Large-scale producers and large-scale users of such natural products as petroleum, ore, coal, and timber usually find the direct method more satisfactory because of the lower costs. A considerable amount of coal, natural gas, products of the sea, and building stone is sold directly by small-scale producers to consumers living near the sources of production. Services, because of their perishable nature and the method of production, are typically sold directly to the user. Illustrations may be secured by observing the marketing practices of transportation, communication, financial, and educational institutions and of individuals¹ in selling their services.

Used by the Manufacturer in Selling Industrial Goods.—The direct method is used by a large number of manufacturers. They frequently send out salesmen and catalogues directly to other manufacturers and to institutions that may have a need for their tools, machinery, supplies, equipment, and other products. This plan appears to be most successful when the users are concentrated in a small area or buy in large quantities or when the product sells for a high unit price. If the product requires a considerable amount of service or if it is a complicated mechanical device which requires technical knowledge for demonstration, installation or servicing or if it is made to order on specifications, the producer may find it advisable to sell direct. This method frequently requires the establishment of branch houses or factory branches or the appointment of special representatives at convenient points so as to be able to render prompt services.

Direct Methods Used by the Manufacturer in Selling to the Consumer.—The direct method is used by the manufacturer in four ways to reach the ultimate consumer, *viz.*, direct from factory door, by mail, by house-to-house salesmen, and through owned retail stores.

Direct from Factory Door.—Some small-scale manufacturers sell all or a large portion of their output directly from the factory to the local consumer. Illustrations of firms following this practice are bak-

¹ While employment agencies aid the employers in locating possible employees and assist the individual in locating vacancies, the actual negotiation and making of the contract, however, are usually carried out by the principals.

eries, ice and ice-cream manufacturers, tailors, and other special-order producers. The incentives for the consumer to buy directly from such sources are lower prices, fresh merchandise, convenience, goods that satisfy certain individual tastes, and loyalty to local enterprises.

Mail-order Method.—A large variety of merchandise is sold by manufacturers as a result of mail solicitation. Such articles as toilet goods, hosiery, men's furnishings, home furnishings, books, art goods, toys, and novelties are being sold in this manner. The major incentives, from the consumer's point of view, are lower prices, better quality, or uniqueness. The consumer frequently purchases in this manner because he sees an article advertised which strikes his fancy and which cannot be found in his local stores. The manufacturer uses this method because he cannot get satisfactory distribution through the established middlemen, wants to control the price, or thinks he can do a better sales job than the middlemen. A manufacturer may decide to use this method when the independent market functionaries refuse to stock his merchandise because it is unknown to the trade, and when the manufacturer is not financially able to introduce the product in the usual manner. If he succeeds in developing a strong consumer demand through his mail selling, the wholesalers and retailers may be willing to assume the sales function.

While almost every type of merchandise has been sold by mail, the method has serious limitations for the typical manufacturer. Sale by mail depends upon adequate description of the merchandise and faith on the part of the buyer in the honesty of the seller. The consumer usually wants to see what he is buying; he may not care to undergo the inconvenience of writing out the order, making arrangements for the payment and the receipt of the merchandise, or waiting an indefinite time for delivery. The manufacturer may find selling by this method uncertain and expensive unless he is well known among the potential customers and the merchandise is standardized as to quality, performance, size, and other essential attributes.

House-to-house Selling.—The number of operators and the relative volume of sales for direct selling increased greatly from 1929 to 1933. The relative volume increased 350 per cent, *i.e.*, from two-tenths of 1 per cent of the total reported retail sales in 1929 to seven-tenths of 1 per cent of the total reported retail sales in 1933. The absolute volume of sales, however, practically doubled. One firm, with 1,170 service salesmen and their supervisory force, was reported to have sold forty-nine packaged grocery products directly to approximately 780,000 housewives located in more than 5,600 cities and towns in thirty-four states.¹ Fifty-

¹ TAYLOR, H. J., American Management Association, *Marketing Executives' Ser.* 67, pp. 9 ff., 1929.

five per cent of this firm's sales volume was in coffee. Other forms of merchandise that have been sold successfully from door to door are dairy products, bakery goods, brushes, hosiery, books, pictures, magazine and newspaper subscriptions, clothing, sewing machines, vacuum cleaners, cooking utensils, patent medicines, and flavoring extracts.

The Place of House-to-house Selling.—This type of selling seems to have a definite place in our marketing organization. The sale of some products requires intensive salesmanship, demonstration, and educational work with the consumer. The typical retailer is not in a position to do this pioneering and educational work. The house-to-house salesman meets the purchaser in her home and shows her exactly how she can use the product. The housewife frequently buys under these conditions because she thinks she is getting a product of higher quality, of better design, or at a lower price than is available otherwise. The inertia of the housewife is overcome by the enthusiasm of the salesman; the result is that many household appliances, for instance, have secured widespread use more rapidly than they would have without house-to-house selling. Some products, because of their perishability, give better satisfaction when sold directly. The specially trained representatives of the alert producer are in a position to give expert directions, with reference to the use and care of the product, to the housewife while visiting each home. This close contact between the producer and the consumer gives the seller first-hand information concerning the changing wants of the consumer, *what* and *how much* she wants, *when* she wants it, and *how much* she is willing to pay for what she wants.¹ This method may furnish the manufacturer a means of reaching the consumer when wholesalers and retailers refuse to handle his goods on a satisfactory basis. The plan may be used temporarily to develop a consumer demand with the intention of selling through the middlemen later.

The house-to-house system of selling obviously has definite limitations. The housewife refuses to give up a large portion of her time to interviewing salesmen; she resents too frequent ringing of the doorbell and inopportune interruptions. Salesmen are likely to find a large percentage of consumers "out" during certain hours of the day, days of the week, and seasons of the year. The plan has encountered serious handicaps in the larger cities because housewives have come to distrust doorbell ringers. Some companies try to overcome this handicap through radio, newspaper, and magazine advertising and by sending or having their salesmen send or deliver a notice announcing the proposed call and by offering a small article of merchandise as a gift. The problem of securing and maintaining a satisfactory sales force is, however, a difficult one for the manufacturer who uses this method.

¹ TAYLOR, H. J., *op. cit.*

A recent survey made by Professor Bader¹ indicates the attitude of the housewife toward house-to-house salesmen. The investigators were able to interview people in only 51.8 per cent of the homes visited. In some instances the people were not at home, but in many instances they were at home and simply did not want to answer the doorbell. Approximately three-fourths of those who answered the doorbell said they opened the door if the ringer looked like a salesman, and almost as many said they granted an interview. Only about one salesman out of four is admitted into the house. The salesman's chances of making a sale are apparently little affected by whether he gets into the house or gives his sales talk at the door. The nature of the merchandise, however, is an important factor in determining whether the sales talk should be delivered in the house. The people interviewed stated that an average of 5.1 canvassers a day called. This appears to be a very high figure. Slightly more than 50 per cent of those interviewed said they never bought. The reason why they bought, given by the largest number of people, was sympathy; convenience was a low second, and a bargain was listed by only thirty-seven of the total number interviewed. A majority reported that they were fairly well satisfied. House-to-house selling should not be permitted, said 204; the other 317 of those interviewed were willing to permit this method of selling.

The survey indicated therefore that the salesman secures an interview in slightly more than half his calls if some one is at home, but he is likely to have to ring 25 doorbells in order to make one sale; and that the majority of purchases are made out of sympathy for the salesman.

It is doubtful whether this method of marketing reduces the costs of selling or lowers the price of the merchandise to the consumer.² According to the expense figures published by the 1933 Census, direct selling was the highest, viz., 40.89 per cent of net sales. This expense is considerably higher than that reported for independent retailers, chain stores, and mail-order houses.

Owned Retail Stores.—There appears to be a trend toward vertical integration among certain types of producers for the purpose of controlling the marketing of their goods. The plan involves setting up a closely correlated machine to perform the wholesale, retail, and other necessary marketing services. The explanation for the increased interest on the part of the manufacturers lies in the changing conditions in the marketing and the production fields. The rapid growth in mass retailing as exemplified by chain stores and in group buying and selling

¹ BADER, LOUIS, "Why and How Often Do People Buy from Doorbell Ringers?" *Sales Management*, p. 368, Apr. 1, 1935. The investigators rang a total of 1,120 doorbells in three towns—Rutherford, N.J., Freeport, Long Island, and White Plains, N.Y.

² *Harvard Business Review*, Vol. IV, No. 3, pp. 326 ff.

has tended to transfer the control of certain markets from the manufacturer to the retailer. Some of the large-scale retail organizations have started vertical integration from the retailer back through the wholesaler to and including manufacturing facilities. The net result is that many manufacturers stand in danger of losing their markets. The drug, grocery, and men's clothing chains, together with the mail-order-house chains and the department-store chains, have been active in certain lines of manufacturing.

The New Competition.—Inventions and more effective sales-promotion activities have brought into prominence the so-called new competition among industries for the consumer's income. The movement has been stimulated by the increased competition that has arisen as a result of increased plant capacity and the ever-widening area of the market. Improved transportation and communication facilities have intensified the condition. Since the variety of commodities and services offered the consumer has increased more rapidly than his income, the manufacturer has greatly increased his sales efforts. One of the plans devised to meet this situation is for the manufacturer to reach out, through his own retail stores, to the consumer. He is thereby able to control prices, the quality of service, and the sales-promotion activities and to gauge more effectively consumer wants, likes, and dislikes. The manufacturer can pass on the valuable experience and information secured from his own retailing experience to the independent retailers who distribute the producer's merchandise in other places.

Among the producers that have been successful in establishing retail outlets are oil, paint, automobile, hat, shoe, clothing, furniture, drug, office-appliance, and candy manufacturers. The locations of these outlets have been confined, generally speaking, to the cities where the demand is large, dense, and fairly stable. Distribution in small towns and in out-of-the-way places is still secured through independent retailers.

Limitations to the Use of the Direct Method.—The direct method of marketing obviously cannot be used advantageously under all conditions. The manufacturer must be in a strong financial condition, have managerial talent capable of supervising the performance of the retail function, and produce on a rather large scale. The demand should be constant and highly concentrated. Manufacturers of a large number of low-priced products, *e.g.*, the manufacturers of a large number of articles found in the typical hardware, department, drug, and grocery store, would not find it profitable to establish retail stores.¹ Goods that are perishable, need servicing, require special training on the part of the

¹ The robot may be used successfully for low-priced, standardized, non-perishable products that are well known and universally and continually used. The problem of servicing, however, prevents the manufacturer with wide distribution from using this device (see pp. 264 *ff.*).

salesmen, and sell at a price that furnishes a comfortable gross margin may be sold by manufacturers through their own retail stores if other conditions are favorable. The ultimate test, however, is the relative cost of performing the marketing functions, and the necessity for rendering technical service.

The Indirect Method.—The indirect method is probably more widely used by producers of agricultural and of manufactured products than any other method. These producers in the past have tended to give their major attention to the technical problems of production. This practice furnished an opportunity for independent specialists in marketing to develop. These specialized market functionaries usually perform the various marketing services more effectively than can the typical manufacturer or farmer.¹ They assemble goods from widely scattered small-scale producers and distribute the merchandise among widely scattered consumers and small-scale business firms. The marketing functions have to be performed by some agency or agencies. The middlemen, by collecting the products of different producers and supplying the needs of many different small-scale buyers, can perform these services, apparently, more economically than the typical producer or consumer.

Used by the Farmer.—Farm products going to the ultimate consumer may be sold to a *local* retailer who in turn sells them to the *housewife*; to a *country shipper*² who sells to a *jobber or wholesaler*, in some distant city, who sells to *retailers*, who in turn sell to the *consumer*; or to a country shipper, who sells through a *commission house*, to a wholesaler or a *jobber*, to a *retailer*, who supplies the *consumer*. Under certain conditions brokers, cold-storage firms, and auction companies are utilized in passing the agricultural products along to the housewife.

If the farm produce is going to the industrial markets as raw material, the method used may be and usually is different. The industrial market is large scale and sets up certain standards as to quality and quantity which must be met. The farmer selling to the industrial market may consign his product, usually in carload lots, to a commission man who sells it for the grower to some manufacturer. Thus commission agents may sell the farmer's car of live stock to the meat packer and his car of grain to a miller. Many farmers do not produce on a large enough scale to sell in carload lots, so they sell to the local shipper who sells through a commission man to a manufacturer or to a warehouse company which sells to a manufacturer or to a shipper who in turn sells to the manu-

¹ Cf. Chaps. V, VI, VII.

² *Country shippers* may be "cash buyers," a local retail store that "buys to ship," a local elevator or warehouseman, a buyer representing some wholesaler in a central market, or a cooperative association.

facturer. Order buyers operating in the central markets buy, for example, a considerable volume of grain and live stock for manufacturers located in other parts of the country. The channels leading to the consumer are more numerous and involved than those going to the industrial market.¹ This is due largely to the size and location of the consumer demand.

Used by the Manufacturer.—A large number of manufacturers producing merchandise for the use of the ultimate consumer typically sell directly to the retailer who in turn sells to the consumer. This retailer may be an independent unit store, a mail-order house, a department store, or a chain. The large meat packers usually sell directly to the retailers, as do some manufacturers of clothing, shoes, furniture, petroleum products, automobiles, and tires.

Table 33, based on the Census reports, illustrates the methods of marketing used by industry. Flour mills, as is indicated, sell 40.3 per cent of their output to independent wholesalers and only 7.7 per cent through their own branches. They sell 27.1 per cent direct to retailers, while 23.5 per cent goes direct to large-scale users. Bolts, nuts, washers, and rivets, to the extent of nearly 70 per cent, are sold direct to large users, while 25.7 per cent is sold to independent wholesalers. Leather gloves and mittens are sold in large quantities directly to independent retailers; 34.4 per cent goes to independent wholesalers. An examination of the table shows that sugar, soap, handkerchiefs, pianos, plated ware, nickel, silverware, pewter, cereal preparations, and coffee are sold chiefly by the indirect method.

The importance of a knowledge of the factors that determine the choice of a method of marketing is illustrated by the following quotation concerning a firm in the oil industry:

Oil companies find it desirable to sell direct to dealers, provided that the consumption per square mile is high. In doing this, they, of course, assume the functions of the wholesaler. Selling direct to dealers puts the manufacturer that much closer to the ultimate consumer. He has the opportunity to see that his product is merchandised in such a way as to enhance its value in the eyes of the consumer. Provided that there is enough sales volume in each locality, it is more profitable; for, obviously, the manufacturer can sell at wholesale instead of manufacturer's prices. But if consumption per square mile is low, selling direct is costly, and it pays to let the wholesaler, already established in the community, market the product.

These principles are recognized by one company which set about to establish a standard by which to measure various parts of the country. Such a standard was afforded by a comparison of sales to cost per square mile. A careful study convinced the company that it was profitable to distribute direct wherever it

¹ Cf. "Methods of Distribution," *op. cit.*, pp. 13, 14.

could sell a certain number of gallons per square mile per annum. Below this, selling direct is unprofitable.¹

TABLE 33.—METHODS OF MARKETING USED BY REPRESENTATIVE INDUSTRIES, 1929¹

Industry	To wholesale distributors		To retail distributors		To users direct, per cent
	Independent, per cent	Own branches, per cent	Independent, per cent	Own, per cent	
Flour mills.....	40.3	7.7	27.1	1.4	23.5*
Coffee and spice roasting and grinding industry.....	21.5	22.9	36.7	14.9	4.0
Cereal preparation (does not include that produced as a by-product in other industries)....	89.7		8.8	....	1.5
Rayon yarn and allied products...	36.0		....	....	64.0
Cotton small-ware industry.....	36.4	1.1	7.8	....	54.7
Wool shoddy.....	40.1	....	....	....	59.9
Bolts, nuts, washers, and rivets..	25.7	4.7	0.6	....	69.4
Plated ware, nickel, silverware, pewter.....	50.8		41.3	....	7.9
Iron and steel forging.....	6.0	1.6	....	....	92.4†
Musical instrument, parts, and materials (except pianos and organs).....	40.1	7.9	32.2	....	19.8‡
Leather glove and mitten.....	34.4	11.2	50.4	....	4.0
Piano.....	10.7	5.5	54.0	21.5	8.3
Handkerchief.....	58.3	9.9	31.6	....	0.2
Soap.....	45.5	32.8	13.6	....	8.1
Cane-sugar refining.....	53.3	26.1	12.1	....	8.5
Beet-sugar refining.....	93.9	....	....	....	6.1

¹ Adapted from U.S. Department of Commerce, *Reports of Bureau of Census*, 1931.

* Bakers, manufacturers of food products, farmers, etc.

† 74.6 per cent to manufacturers; 17.8 per cent to railroads and contractors.

‡ Household users 15.7 per cent.

What Limits the Number of Retailers That Can Be Sold Directly.—
 The major limitation on the number of retailers that can be sold directly is the *cost* of selling them. It has been estimated, for instance, that there are not more than 2,000 department stores and 2,500 drug stores that do a sufficient volume of business to warrant manufacturers of toilet goods to sell them directly. These stores, located usually in towns of

¹ BRUNER and LAZARUS, *Applied Budgeting*, Chap. II, pp. 33 f.

25,000 and above and confined to congested shopping districts, sell approximately two-thirds of the toilet goods.¹

Advantages to Manufacturer in Selling to Large-scale Retailers.—The following quotation indicates the possible effect of large-scale retailing upon the manufacturer's costs of selling:

Due to changes in distribution which have taken place during 1927 and 1928, it now takes 17,500 less traveling salesmen to sell the 11,000 items stocked in grocery and drug stores.

The elimination of these salesmen represents an annual saving of approximately \$87,000,000 in selling expense. The new trend is due to three influences. First, the retailing is in fewer hands today, as shown by the fact that five companies alone control 17,000 grocery stores. Naturally, fewer salesmen are needed to call upon them. Second, in many cases, the chain orders direct without any contact with the salesmen, and, in a number of instances, the president of the drug or grocery manufacturing company finds it more profitable to call on the heads of the larger chains himself.

The third fact is the consolidation of manufacturers, similar to the Postum Company, so that one salesman can sell more than one item. Our studies have shown that a salesman can sell five items to the drug and grocery trade without any loss of efficiency. With wholesalers now combining in a large group, also, this will reduce still further the number of salesmen needed. It was found, in one recent consolidation, that 400 people were eliminated in the accounting department also, cutting down the tremendous amount of clerical work involved by each individual company when selling to the 400,000 drug and grocery outlets.²

Many producers look with favor upon sales to large-scale retailers. The large orders placed tend to reduce the costs of production and of marketing for the manufacturer. The orders are usually given well in advance of the time of delivery, which reduces risks and permits production planning. The large number of outlets and the wide extent of territory covered by the large-scale retailer furnish the manufacturer more effective distribution of his product.³

Exclusive Agency.⁴—A producer that lacks the financial resources or the volume of production necessary to make direct selling profitable may find it advisable to organize exclusive agencies and in this way

¹ SLATER, A. L., *Advertising and Selling*, p. 21, Jan. 9, 1929.

² BAXTER, W. J., *Retail Ledger*, first November issue, 1928.

³ It should be kept in mind, however, that the large-scale retailer may secure such a dominant position in the marketing organization of the manufacturer as to deprive him of all independent action.

⁴ "Any agreement to sell within a certain territory a commodity or service through only one company or individual constitutes an unlimited or single exclusive agency. The contract may be written or oral. The product must be identified by brand or trade-mark, and the dealer who acts as agent is under a moral obligation to develop his market in a business-like way." New York University Bureau of Business Research, *The Exclusive Agency*, p. 1.

establish a highly desirable form of selective distribution. All products manifestly are not suited to the exclusive-agency method. According to the New York University study, building material, grocery specialties, druggists' sundries, toilet preparations, hosiery, underwear, jewelry, and office appliances are not generally sold through exclusive agencies. Products such as the following seem to lend themselves to this plan of selling: new or relatively unknown goods; high-priced "shopping lines" requiring service to consumers and having a dominant style or quality element; and merchandise of which a full line must be carried. Farm machinery, furniture, men's and women's clothing, branded shoes, radios, pianos, mechanical refrigerators, automobiles, washing machines, automobile tires, oil burners, and paints are good examples. Many exceptions, however, are found.¹ Firms within the same industry, operating under similar conditions, frequently use different methods. The explanation for the difference is usually found in the differing opinions of the managements as to the relative advantages and disadvantages of the various methods.

Advantages and Disadvantages to the Manufacturer.—The manufacturer may wish to establish exclusive-agency agreements for several reasons. The more important ones are to secure aggressive selling through a greater personal and financial interest on the part of the dealer; to prevent price cutting; to maintain the prestige of the firm and of the product; and to insure satisfactory service to the buyer. The plan may not always produce the anticipated results. The volume of sales, in fact, may be restricted by limiting the selling to a selected few. The agent may not always cooperate in a wholehearted manner; he may even push competing lines or sell substitutes.

Advantages and Disadvantages to the Dealer.—The dealer in accepting an exclusive-agency contract hopes to secure certain advantages, such as increased prestige from being designated as the exclusive distributor of a well-known and highly esteemed line of merchandise, freedom from competition from other dealers in his own territory selling the same goods, assistance in advertising, and quantity discounts. He is likely, under the guidance of the manufacturer, to maintain better balanced stock and to realize a higher rate of turnover. There are some possible disadvantages to the dealer; *e.g.*, the manufacturer may decide to abandon the exclusive-agency system, or select a different merchant after the first one has spent considerable effort and money in developing local recognition and desire for the product. If the dealer agrees not to handle competing lines, he is likely to reduce the volume of his sales

¹ During 1935, for example, a number of refrigerator manufacturers began selling their product through department stores. The consumer is now able to compare and contrast the different machines under favorable conditions.

materially and thus cut his profits. The manufacturer usually retains a definite control over prices and stocks which may restrict the dealer's total volume of sales.

It is obvious, from the foregoing discussion, that the exclusive-agency method has a place in our marketing system but there are definite limitations to its use. There must be an identified product of a kind suited to the plan, and the advantages to the manufacturer and to the dealer must outweigh the disadvantages, or the plan will be abandoned.

When to Use the Wholesaler.—Producers of a large variety of products, such as manufacturers of groceries, dry goods, drugs, hardware, electrical appliances, and automobile accessories, typically sell to wholesalers, who sell to retailers, who in turn sell to consumers. Many of these goods are produced by small-scale manufacturers and flow in small quantities to a large number of widely scattered retailers. It is usually more economical under such conditions for the manufacturers to use the wholesaler. Products that demand dense distribution, such as low-priced, frequently bought convenience goods, are usually distributed more economically through the wholesale-retail channel. If the product is a specialty of high value and is purchased at infrequent intervals, a system of selective distribution may prove more effective. Producers of seasonal merchandise, such as the canners of fruits and vegetables, typically use brokers in locating wholesalers. The manufacturers of grocery and hardware specialties sometimes use so-called manufacturers' agents who sell to wholesalers.

Selling Food Products from Trucks.—A method of marketing food products, which is in reality a combination of simultaneous selling and delivery, has been in use for a number of years. The firm using the method may be a wholesaler or a producer. The driver of the truck is a salesman who follows a regular route on a predetermined schedule. He sells, delivers, and collects. The plan has certain obvious advantages, such as prompt delivery, a close and friendly relationship between the salesman and the retailer, and no credit losses. This type of selling often reaches small retailers who are not adequately serviced by other types of wholesalers. Large-scale retailers likewise buy some merchandise by this method. The success of the plan depends on the character of the product, the nature of the demand, and the density of the retail outlets. The place of "truck selling" in our marketing organization was reported on by Dr. Sandburg.¹ The following summary gives some of the results of his study:

By avoiding separate visits for selling and delivery, truck selling effects savings in expense for personnel, equipment; operation, and order handling.

¹SANDBURG, L. J., *Truck Selling*, Harvard University. Graduate School of Business Administration.

These savings, however, can be realized only when the salesman is able to anticipate closely the kinds of goods, and the quantities of each, that his customers will order. This ability to anticipate demand accurately usually exists only when the number of products are small and when the demand is relatively stable, and when there is high frequency of sale. Thus, it is concluded, truck selling is advantageous only in the relatively few instances in which these conditions are accompanied by the desirability of specialized, intensive sales effort.

Truck selling was found to be employed by two groups of distributors: Truck wholesalers or "wagon jobbers," and manufacturers. Truck wholesalers are numerous, but relatively unimportant in wholesale food distribution, since they account for less than $\frac{1}{2}$ of one per cent of the wholesale sales of the goods concerned. They are valuable especially to small manufacturers and to larger manufacturers for the distribution of perishable products. They are of service also in distributing miscellaneous products to retailers not effectively served by other types of wholesalers.

Some of the truck sellers have been quite successful in maintaining a stable volume of business on a high basis by combining a few lines of merchandise which supplement each other during the different seasons. Thus products in great demand during the summer are replaced in the autumn by products that are wanted in the winter. Some of the more successful operators of this type limit their line during any one season to eight or ten products.

Manufacturer to the Industrial Market.—Although the typical method of selling goods to be used for production purposes rather than for personal use is the direct method, a considerable volume passes through the hands of jobbers and manufacturers' agents. There are large numbers of small-scale manufacturers and institutions whose demand for manufactured goods is so small and irregular that the producer may find the cost of direct selling prohibitive. He may sell, in such cases, to jobbers and supply houses who in turn sell to the industry; in other instances he may distribute his product through a manufacturer's agent. The agent usually sells several non-competing lines of products put out by different manufacturers. The increased volume secured thereby gives the agent a lower selling cost than the several individual manufacturers could attain. A manufacturer, as was stated above, may sell directly in a highly concentrated market and through middlemen in the remote and thinly settled districts.

Methods Used in Marketing Selected Groups of Products.—Table 34 indicates the methods of marketing three selected groups of products. The first group (A) comprises those products that are sold chiefly by the indirect method, yet a larger portion of these goods is sold directly to the ultimate consumer than any of the products in groups B and C. Automobiles are sold directly to the user to the extent of 18.30 per cent; only 0.22 per cent go directly to industry, but 81.48 per cent are sold

indirectly; 11.57 per cent of the electrical refrigerators are sold direct to the consumer, but 85.45 per cent go through various types of middlemen. The products in group B illustrate the type of goods that are sold directly to industry. At least 50 per cent of these goods are sold by the direct

TABLE 34.—METHODS OF MARKETING SELECTED GROUP OF PRODUCTS¹

Products	Percentage going		
	Direct to		Indirect to all others
	The con- sumer	Industry	
Group A:			
Automobiles and other vehicles.....	18.30	0.22	81.48
Refrigerators (electric).....	11.57	2.98	85.45
Musical instruments and sheet music.....	9.09	1.10	89.81
Farm machinery and equipment.....	3.15	7.35	89.50
Professional equipment and supplies.....	3.16	8.26	88.58
Hardware (general line).....	2.73	17.00	80.27
Group B:			
Metals and minerals (except petroleum and scrap).....	0.45	73.55	26.00
Textiles and textile materials (other than dry goods).....	0.40	66.22	33.38
Manufacturing, mining, and drilling equip- ment and supplies.....	0.83	64.41	34.76
Electrical goods (including appliances)....	0.68	61.98	37.34
Piece goods.....	0.14	51.76	48.10
Coal.....	1.33	44.91	53.76
Paper and paper products (specialty).....	0.48	43.61	55.91
Group C:			
General merchandise.....	0.49	35.19	64.32
Hardware (specialty).....	0.91	34.20	64.89
Groceries (general line).....	0.24	.....	99.76
Fruits and vegetables (fresh).....	0.33	.....	99.67
Tobacco and tobacco products.....	0.55	0.13	99.32
Meat and meat products.....	0.85	0.24	98.91
Fish and sea foods.....	1.59	.....	98.41
Drug and drug sundries (general line)....	0.29	1.66	98.05
Furniture.....	0.59	1.42	97.99
Books, periodicals, and newspapers.....	1.53	1.14	97.33
Tires and tubes.....	0.85	1.86	97.29
Dry goods and apparel.....	0.24	2.68	97.08
Drug and drug sundries (specialty).....	0.40	3.46	96.14
House furnishings.....	0.79	2.30	96.91

¹ Adapted from *Wholesale Distribution for the Year 1929*, U.S. Department of Commerce, Bureau of Census, p. 73, 1930.

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method, with the exception of coal and paper specialty products; 53.76 per cent of the former and 55.91 per cent of the latter are sold indirectly. Group C comprises typical consumer goods which reach the ultimate user through the hands of the commonly known marketing functionaries. It is interesting to note that more than 99 per cent of the general line of groceries, fresh vegetables, tobacco, and tobacco products are sold by the indirect method. Meats, fish, drugs, and furniture are likewise sold predominantly by the indirect method. The nature of these goods, the character of the consumer demand, and the size and location of the producers are all factors influencing the decision to market these goods by the indirect method.

The Cooperative Method.—The cooperative method of marketing appears to be gaining popularity rapidly. Producers, consumers, and merchants¹ form associations for the purpose of performing a number of the important functions incident to selling their products or buying their stocks of merchandise, supplies, and equipment. These organizations do not abolish any of the important marketing services performed under the non-cooperative plan, but some of the independent marketing functionaries are displaced. The cooperative plan, in its comprehensive form, brings about integration which makes large-scale marketing operation possible. The success of any cooperative plan depends upon the ability and honesty of the management, the loyalty of the members, and the economic and social need for this particular method of marketing. The use that cooperative associations make of existing marketing functionaries varies. So far there are relatively few instances in which an association performs all the functions. The objective of the agricultural cooperative associations is to bring about "orderly marketing"; i.e., agricultural products in the desired quantity and of the desired quality will be sent to the right market at the right time. The economies of centralized, large-scale marketing are secured.

Cooperative Buying.—Farmers, either through informal groups or through organized associations, buy large quantities of farm machinery and implements, flour, feed, seed, fertilizer, binding twine, oil, coal, paint, insecticides and fungicides, and other merchandise. Since they buy in large quantities, purchases are usually made directly from producers and wholesalers, frequently with the benefit of quantity discounts.²

¹ For a survey of cooperative buying among merchants, consult W. L. White, *Cooperative Retail Buying Associations*.

² More than 2,000 agricultural cooperative associations which purchase farm supplies responded to a request for information by the Farm Credit Administration; 141 of these associations reported a total volume of approximately \$89,000,000; 16 additional associations reported a total business of approximately \$67,000,000. These figures include only the purchase of supplies for the farmers. Farmers in Oregon purchased cooperatively more than \$2,000,000 worth of supplies in 1933.

The local retailers try in various ways to discourage such practice. They sometimes refuse to sell the merchandise of a manufacturer who sells to the cooperative buying clubs. If the association goes out of business, the manufacturer may find that he has lost a valuable market because of the boycott of the local merchants. The cooperative movement has now become so firmly established that it must be regarded as a permanent part of our marketing structure.

Cooperation among Manufacturers, Wholesalers, and Retailers.—Manufacturers have also entered the field of cooperative marketing. The cooperative plan developed by McKesson & Robbins brings together a chain of wholesale drug houses, manufacturers, and a large number of retail drug stores. The retail organization is designated as the McKesson Service Stores, and each member agrees to purchase a substantial portion of its requirements from the company and to promote the sale of the McKesson & Robbins products and those of manufacturers with which it is identified. The idea is to give the retailer a "merchandising service with the advantage of centralized collective buying."

This great interest on the part of independent retailers, service wholesalers, and certain manufacturers in the cooperative method of marketing manufactured goods is largely the result of the rapid expansion of large-scale retailing. As was stated in the preceding chapter, much has been made of certain advantages enjoyed by the chain stores. The cooperators hope to secure these advantages, retain those of individual ownership, and at the same time avoid the disadvantages inherent in the chain system.

The entire cooperative movement is a manifestation of the current desire to *control* the marketing process by the independent merchants. These objectives may be attained in certain instances, yet there are definite limitations to the possibilities. One student of marketing, in speaking of the cooperative retail movement, sums up the situation in the following words:

There has been no movement among independent retailers in recent years so widespread, so carefully considered, and so full of possibilities for good and at the same time for waste, if not properly conducted, as cooperation among retailers. In a very real sense, cooperation is the only effective means of meeting the independents' present-day problems.¹

The smallest association handled \$3,500 worth of purchases, and the largest handled \$431,000 worth. Farm Credit Administration, *News for Farmer Cooperatives*.

Farm cooperatives made purchases during 1927 in excess of \$300,000,000. Each of three large purchasing associations bought goods during 1928 valued at more than \$10,000,000; two others made purchases in excess of \$4,500,000, while at least nine others did a purchasing business in excess of \$1,000,000 each. Farmers' selling cooperative associations are discussed in Chap. XIX.

¹ NYSTROM, P. H., *Economics of Retailing*, Vol. 1, p. 396.

The Common Element in Cooperative Plans.—The common element in all these cooperative plans, as a method of marketing, is an attempt to secure the advantages of large-scale marketing. Lower prices to the consumers and greater profits to the producers and the merchants are the ultimate goals. The motivating force is not a social one but a desire to improve the economic status of the members. The wholesalers are anxious to cooperate with the retailers in order to keep themselves in business. The independent retailers are willing to cooperate with each other and with the manufacturer and the wholesaler in order that they may receive lower prices and assistance with newspaper and radio advertising, displays, store layout, and other services designed to improve their merchandising practice and competitive position.

Mechanical Methods of Selling.—Enormous pressure is being constantly exerted to reduce the costs of marketing. This movement is exemplified through a more intensive use of mechanization in marketing, resulting in a reduction of man power (labor), a greater degree of simplification and standardization of easily understood and determinable grades and labels, a reduction in wastes, resulting from useless duplication in sizes, shapes, prices, services, retail outlets, and sales-promotion devices and methods. An interesting example of this drive for lower cost is the use of various forms of automatic selling devices of the mechanical type.

The annual volume of business secured by means of vending machines has been estimated as high as \$100,000,000. These machines have certain advantages, such as convenience as to time, place, and service. They do a strictly cash business, attract attention, and, no doubt, secure a considerable amount of business because of their novelty. They can be placed in strategic locations, where the machines store, display, advertise, and deliver the goods and collect the payment. They have been called complete stores within themselves.¹ There is considerable expense, however, involved in servicing the machines. They must be restocked, kept in good mechanical condition, and the money collected. They are likely to receive hard usage which results in high operating costs.

It is commonly recognized that not all kinds of merchandise can be sold successfully by vending machines. The product must fulfill six requirements, according to Mr. Alexander, as follows:

First: the article must be packaged ready to take away; or it must be consumed on the spot like a drink.

Second: to sell best, it should have a consumer demand built up through advertising, sufficient to sell itself.

Third: the article must be small enough so that a large number can fit into a machine of reasonable size.

¹ ALEXANDER, H. W., of the H. W. Alexander Company, sales engineers, New York.

Fourth: easily perishable goods should not be placed into machines, for the theory is that machines should stand any kind of climate and temperature so that they can be refilled at intervals of several days as need be. This does not apply where a cooling unit is in the vending machine or, for instance, oranges or apples, which are not easily perishable. Of course it does not apply to automatic restaurants, as the food is sold so fast it has no time to perish.

Fifth: the price of the article sold should be not more than 25¢. Above 25¢ customers want to look the goods over. At 50¢ they want to examine them and ask questions. The vending machine is really a penny, nickel, dime and quarter product distributor. Not long ago a high class department store told me they could not afford to sell less than 50¢ drug items, considering overhead and space. There was space, however, in the store along the wall and around the pillars for quarter vending machine units and they told me they now planned their installation, for it is good space and they require no sales help.

Sixth: machine vended articles must be standardized. You will see that the present development in merchandising fits mechanical selling; that is, national advertising, standardization and packaged goods.¹

Some form of organization is necessary to buy the products sold through the vending machines, to secure suitable locations, and to provide adequate servicing. The manufacturers of the merchandise sold are not likely to perform these services. The typical wholesaler cannot do it. Retailers of various kinds frequently buy or lease the machines and service them. In other instances individuals or small firms specializing in this type of selling buy the machines, arrange for suitable locations in places accessible to large groups of possible consumers, buy the merchandise needed on a wholesale basis, and service the machines. An individual with a relatively small number of machines advantageously located has been known to secure a very satisfactory return on his investment, for the risks involved, and for the time required for servicing.

Method of Analyzing Problems of Marketing.—Our previous discussion has pointed out the nature of the various marketing functions, indicated their influence upon the character of the institutions that have been developed to perform the functions, and analyzed the factors that determine the choice of methods of marketing. The next section, Part III, presents in a descriptive-analytical manner factual material concerning the marketing of agricultural, natural, and manufactured products and of services. We present at this point a more detailed outline of our method of analyzing marketing problems.

The Method of Analysis.—Time and space do not permit a detailed discussion of the processes of marketing each and every economic good found in the world's markets. Such a method of approach, moreover, is not advisable for the general student of marketing, as it would involve

a large amount of useless repetition. Our purpose is adequately served by classifying all economic goods under four major classifications, and then discussing the practices followed in marketing some of the major groups in each classification. The method of analyzing the problems of marketing specific commodities and services is indicated by the following outline.¹

OUTLINE OF METHOD OF ANALYSIS

- I. The demand factors:
 1. Major uses.
 - a. Industrial use.
Raw materials, power, equipment, supplies, etc.
 - b. Personal use of ultimate consumer.
 - c. Possibility of increasing consumption through developing new uses, decreasing consumption from many causes.
 2. Large scale versus small scale.
 3. Volume and quality of demand, the unit of purchase.
 4. Geographical, sociological, and industrial distribution, proximity to place of production.
 5. Density and stability—seasonal, secular, cyclical variations, frequency of purchase, reorders.
 6. A buyer's versus a seller's market.
 7. Degree of elasticity.
 8. Degree of specialized demand, *i.e.*, made to order, versus staple.
 9. Relation of the demand for this product to use of other products.
 10. Degree of skill in purchasing exercised on part of buyer.
 11. Buying habits of purchasers and users.
 12. Importance of the style element.
 13. The need of financial assistance—credit, installment payments, etc.
 14. Governmental control—tariffs, quotas, embargoes, taxes, pure food laws, codes, A.A.A., N.I.R.A., etc.
- II. The supply factors:
 1. The product.
 - a. Size, degree of bulkiness, and concentration of value.
 - b. Perishable versus non-perishable; sources of risk—climate, disease, insects, etc.
 - c. Standardized versus non-standardized as to quality, size, design, grade, etc.
 - d. Independent, joint, or by-product.
 - e. Need of expert or technical service for demonstration, installation, service, etc.
 - f. Identified versus unidentified.
 - g. Points of superiority, weakness, etc.
 2. The method of production.
 - a. Small-scale versus large-scale.
 - b. Produced by nature, tools, machinery; degree of skill, organization, specialization required.

¹ For a somewhat similar outline, cf. E. L. Rhoades, *Introductory Readings in Marketing*, Chaps. II, III.

- a. Volume of production—the supply, degree of monopoly, possible and probable substitutes, forms of regulation of supply, quality, etc.
- d. Geographical distribution of producing units. Factors determining their location, degree of concentration.
- e. Stability of production—seasonal, secular, cyclical.
- f. Length of production period, the amount of capital required.
- g. How affected by law of diminishing returns or increasing costs.
3. The producer.
 - a. Alert, aggressive, and progressive versus high degree of conservatism; the personal element—labor and professional services.
 - b. Attitude toward cooperative movement.
 - c. Economic, sociological, and political status.
 - d. Attitude of producer toward the middlemen.
4. Governmental control—nature, amount, trend.
- III. Services necessary and the agencies that perform them:
 1. Possible services.
 - a. Buying—assembling, collecting, concentrating.
 - b. Selling—advertising, displaying, installing, and demonstrating.
 - c. Grading—standardizing.
 - d. Transporting, storing, financing, and risk bearing.
 2. Possible agencies.

Merchants, agents, exchanges, auctions, cooperative associations, warehousemen, grain elevators, market news agencies, banks, commercial paper houses, transportation companies, insurance firms; city, state, and federal governments.
 3. Services and agencies for:
 - a. The *concentration* process in the local, central, and terminal markets.
 - b. The *dispersion* process to the industrial, institutional, and consumer markets.
- IV. The methods of marketing used, and why:
 1. Direct.
 2. Indirect.
 3. Cooperative.
 4. Combination of two or more of the foregoing.
 5. Why the particular method is used in each instance.
 6. The present trend.
- V. The major problem met and its possible solution.

It is evident that all points listed in the outline are not applicable to the problems encountered in marketing every product. The majority of points, however, may be applied to a very large number of economic goods. The outline serves to illustrate a method of analysis of the marketing process which, it is believed, will tend to develop an appreciation of the magnitude of the problems encountered. Its use may aid in promoting clear and sound thinking along the lines that will develop satisfactory answers to some of our more pressing marketing problems.

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 For an interesting group of criticisms of our present-day marketing policies, organization, and methods, consult the following:
 BORBODI, RALPH, *The Distribution Age*.
 CHASE and SCHLINK, *Your Money's Worth*.
 GUNDLACH, E. T., *Old Sox on Trumpeting*.
 VAUGHN, F. L., *Marketing and Advertising*.

Questions for Discussion

1. What is meant by the terms "marketing methods," "channels of distribution," "middlemen," "shortening the channels of distribution," "eliminating the middleman"?
2. What is meant by the terms "direct method of marketing," "indirect method of marketing," "cooperative method"?
3. "No distributing device is permanent; most of them are of fairly recent origin in their present form. The distributing functions are the durable elements of the problem." What is the significance of this statement to the student of marketing? What is meant by the term "distributing functions"?
4. "Five classes of proposals have been made to lessen the expenses of market distribution: first, to decrease the number of middlemen; second, to shorten the trade channels; third, to organize cooperative marketing organizations; fourth, to develop cheaper or more efficient methods; and, fifth, to have public regulation. Several of the suggestions in the fourth class involve a lessening of service to the consumers." Evaluate in detail each of these proposals.
5. "High-pressure wholesaling makes each manufacturer duplicate the wholesaler's activities; it produces duplicate selling staffs; duplicate credit departments; duplicate accounting departments; duplicate shipping departments." Assuming these statements to be true, does this situation necessarily increase the cost of marketing? Justify your answer.
6. What classes of goods are usually sold directly to the consumer? Why? What are the advantages and the disadvantages of this method of selling? What are the leading types of organizations that have been developed for direct selling?

7. What are the principal motives for direct manufacturing-retailing relationships? What are the circumstances that make this direct contact feasible? When is such relationship not feasible?

8. "Based on our experience we have chosen the exclusive dealer plan as the more economical and satisfactory of the two methods, as it has proved to offer these six advantages: (a) it increases sales and lowers selling cost; (b) it provides more regular and dependable volume of orders; (c) it obtains a more uniform distribution; (d) it makes customers more loyal to the line; (e) it makes it easier to maintain retail prices; and (f) dealers take more interest in actually selling and advertising the line." Do you agree? Justify your answer. What is an exclusive agency?

9. "The final consideration, however, must be the effect upon the public—the ultimate consumer. Does the exclusive agency plan make for higher or lower retail prices, or simply for uniform prices? Does it provide the variety and satisfaction which consumers want? What effect has it upon the quantity of the manufacturer's output; upon his net profits? Does it really make for steady and satisfactory relationships between producers and distributors? Does it remove the stimulus of competition for the potential market? Does it encourage the substitution of competing merchandise on the part of other dealers?" Summarize the advantages and the disadvantages of the exclusive agency to (a) the manufacturer, (b) the dealer.

10. What general factors and conditions determine the selection of any particular method of marketing?

11. What factors determine when a producer should use (a) commission men, (b) brokers, (c) sales agents?

12. Why has selling through commission agents declined? Why has the method not been completely abandoned? What products are typically sold through commission agents? Why?

13. "The producer can no longer take the time to hunt up buyers for his wares." Evaluate this statement.

14. "The general advantages of the middleman system are the advantages of specialization and of division of labor by independent units." Criticize this statement.

15. "The wastes of high-pressure marketing can be eliminated and the cost of distribution lowered if the retailers and wholesalers of the country would, first, accept full responsibility for the task of furnishing to the consumers of the nation the products of our farms and factories; second, buy according to established grades and standards in order to make production subservient to consumption; and, third, promote consumer education as to merchandise." Do you agree? Justify your answer.

16. List the different types of cooperative associations. State the chief functions of each. How do you account for the development of the voluntary chains?

17. "Producers' cooperation in agriculture seeks to accomplish certain definite objectives." What are they?

18. What is integration in marketing? Under what conditions is there a tendency toward integration? Does integration help to reduce marketing expenses? Cite illustrations.

19. What is the relation between integration and the choice of a method of marketing?

20. Why do some producers simultaneously use more than one method of marketing? Give illustrations of such practices. Why do some producers in an industry use a different method of marketing from other members of the same industry?

Assignment

1. *Written Reports.*—Prepare a brief, concise report of approximately 2,000 to 2,500 words on one of the following subjects: (1) chain stores, (2) voluntary chains,

(3) department stores, (4) mail-order houses, (5) present status of wholesaling or retailing, (6) agricultural wholesale and terminal markets, (7) agent middlemen, (8) produce exchanges, (9) the public warehouse, (10) the merchandise broker, (11) the manufacturer's agent, (12) the use of the direct method of selling. Cover in this report such points as historical development; need for such services; advantages and disadvantages of this particular agency, its organization and operation; costs of performing the marketing function or functions by this organization; the future possibilities of growth or decay; effect of recent legislation.

II. Problems.

1. Problem 2, p. 184. Nash Motors Company—Method of Marketing.
2. Problem 2, p. 145. Spencer Company—Cooperation between Wholesaler and Retailer.
3. Problem 1, p. 227. Blatchford Mills—Direct Sales.
4. Problem 2, p. 160. Davenport Tire Company—Exclusive Agency Plan.
5. Problem 2, p. 165. Land O'Lakes Creameries, Inc.—Marketing Methods of a Cooperative Organization.
6. Problem 1, p. 266. Strength Union Company (A).
7. Problem 3, p. 292. Duran Machinery Company—Manufacturers' Agents.
8. Problem 2, p. 400. Cotchpinicott Worsted Mills, Inc.—Selling Agents.
9. Problem 1, p. 304. United Shoe Machinery Corporation—Lease System.

PART III
MARKETING PRACTICE

CHAPTER IX

MARKETING AGRICULTURAL PRODUCTS—FARM CROPS— GRAINS, FRUITS, AND VEGETABLES

Purpose of this chapter: To determine the source of the agricultural marketing problem; to analyze the factors that control the methods followed in marketing grains and fruits and vegetables.

The Agricultural Marketing Problem.—The productive capacity of American agriculture was increased greatly during the period 1915–1921 to meet the unprecedented European demand resulting from the war. The fighting European countries obviously were not able to maintain their normal output of agricultural products during the war. This situation threw the burden of making up the deficiency and supplying the increased demand upon the rest of the world. The submarine activity and the withdrawal of shipping facilities from the Far East and some other sections of the world prevented the products of Australia, India, the Orient, and South America from reaching their customary markets. The result was that the United States and Canada greatly expanded their productive facilities to meet the war demand for food, clothing, and munitions. With the high prices for agricultural products, which resulted from the greatly stimulated demand, came speculation in agricultural lands. The prices of farms rose spectacularly, farmers and others bought and sold farms at ever-increasing prices and used the mortgage as the chief financing vehicle.¹

There was a slow increase in product and land values during the period 1900–1912; during the period 1915–1920 the prices of agricultural products increased at a rapid rate. This increase in commodity prices was transferred to land values with the result that the prices per acre of farm land in certain sections of the corn and wheat belts increased 300 and 400 per cent within a period of three years. This speculation in land was widespread. It was not uncommon for the price to increase as much as \$25 an acre between sales and for a farm to change owners two or three times a year. Many farmers found themselves, when the deflation storm hit in 1921, the nominal owners of farms that could not be sold for even the amount of the mortgages. The amount of the loan, in fact, was frequently as much as 25 to 50 per cent more than

¹ In the early stages of the inflation some farmers were able to pay for their farms from the proceeds of one year's production.

the deflated value of the farm. The interest charges and taxes in many instances far exceeded the cash income available, leaving nothing to the farmer for his own equity, his labor, and his investment in stock and machinery. The price of farm lands continued to decline through 1932.¹ The adjustment between the price of land and the value of the crops that can be produced thereon must be completed before a stable price for farm lands can be expected. The losses of individual farmers, banks, and insurance companies resulting from the drastic decline in agricultural prices during the period 1921-1932 were staggering.

What Is the Explanation?—When the war ended and the participating countries resumed production, and when the shipping facilities were redistributed, the American farmer found his wartime foreign market shrinking. To make matters worse, many of the foreign countries that formerly imported our agricultural products in large quantities began to pay bounties and benefits to their own citizens to increase home production. This practice was often accompanied by the imposition of quotas and/or tariffs on imports. The result was that some former importing countries increased their output to such an extent that they not only met their own domestic needs but also had a surplus to throw upon the already over-supplied world market.² When the depression of the 1930's arrived agricultural conditions in the United States grew worse, owing to the now much more rapidly declining prices. Low prices for agricultural products reduced the purchasing power of farmers; consequently, they bought less manufactured goods—automobiles, machinery, clothing, etc. The reduced sales of these manufactured goods tended to increase unemployment in the cities and thereby reduced the purchasing power of the urban buyers of agricultural products, which caused the prices of these commodities to fall still more.

¹ The value of farm real estate in 1924 was \$14,323,000,000; in 1932 it was \$8,170,000,000. Personal property value of farmers in 1924 was \$2,937,000,000; in 1932 it was \$1,811,000,000.

² France, for instance, was a major wheat-importing country until the late 1920's when the government instituted a plan for fixing the internal price at a level to stimulate domestic production. The resulting extension in acreage produced an exportable surplus which proved financially embarrassing in 1933 and 1934. The government made the mistake of fixing prices without limiting the acreage. The exportable surplus for 1934 was estimated at from 80,000,000 to 110,000,000 bushels. The plan was financed by a 3-franc—later 7-franc—per quintal milling tax. The price of wheat in France reached approximately \$2.60 a bushel in 1934. A number of European countries not only paid bounties on domestic production but applied milling restrictions which forced millers to use a large proportion of native wheat. The subsidy paid in Holland was approximately \$1.63 a bushel. The Minister of Agriculture stated in 1934, "Unlimited production must in the end only defeat itself." Germany, Italy, Belgium, and Denmark were other European countries that artificially stimulated the production of agricultural products.

Table 35 suggests the drastic decline in the gross income of farmers from 1930 to 1932 and 1933. This table also indicates the relative positions, on the basis of sources of income, of the ten major commodities produced by farmers. The dominant position in the farmer's economic welfare held by animals and animal products is clearly demonstrated. The income received from milk, or hogs, or cattle, it will be noted, is much more important to the farm population than that received from wheat and until 1933 was more important than cotton. The income derived from eggs exceeded that received from cotton in 1930 and was greater than that received from wheat in 1930, 1932, or 1933. The income received from chickens, eggs, and cattle and calves was lower in 1933 than in 1932; the income from cotton was considerably above the 1932 figure and only slightly below the 1930 income.

TABLE 35.—GROSS FARM INCOME FROM TEN MAJOR COMMODITIES, 1930, 1932, AND 1933¹

Commodity	1930	1932	1933
Milk.....	\$2,030,853,000	\$1,260,424,000	\$1,262,554,000
Hogs.....	,349,658,000	538,023,000	618,604,000
Cattle and calves.....	951,480,000	502,472,000	489,171,000
Eggs.....	661,414,000	358,856,000	344,803,000
Cotton.....	659,032,000	397,295,000	633,266,000
Wheat.....	410,635,000	176,617,000	280,044,000
Chickens.....	382,211,000	240,583,000	206,920,000
Truck crops.....	363,140,000	220,767,000	225,441,000
Potatoes.....	259,071,000	114,405,000	222,932,000
Farm gardens....	213,568,000	210,142,000	219,085,000

¹ U.S. Department of Agriculture, Yearbooks of Agriculture, 1934 and 1935.

Demand Factors.—Certain fundamental factors are affecting the demand for and the supply of agricultural goods. While the relatively rapid growth of the urban population has tended to increase the demand for agricultural products, the widespread use of the tractor, truck, and automobile has displaced large numbers of horses and mules. The sale of corn, oats, hay, and other farm products used for feed has been greatly reduced as a result. The automobile and truck have displaced, according to some estimates, 10,000,000 horses and mules, thus eliminating the demand for feed stuffs from 40,000,000 acres of land. The low prices of hides and leather reflect the effect of the reduced demand for harness. The demand for wool and cotton has been curtailed owing to changes in fashion, changed habits of living, and competition of cloth made from other materials. The population of the country is not increasing at so rapid a rate as it did prior to 1917. The European demand for our agricultural products seems destined to decline because of tariffs and

competition from increased production in the surplus-producing countries of the world, i.e., Canada, Argentina, Australia, and Russia.

The demand for agricultural products, in the aggregate, is large. These products are used on a large scale by industry as raw material and on a small scale by the ultimate consumer as food. Changes in dietary habits and in methods of dress and living have greatly affected the demand for many important agricultural products.

There is a close relation between the density of population and the demand for farm produce. The stability of demand depends to a considerable extent upon the degree of prosperity among the urban population. When this group is steadily employed at a satisfactory wage, it buys agricultural products in large quantities and is willing to pay prices that are satisfactory to the farmer. The demand for these goods is, generally speaking, inelastic.

The demand for some American agricultural products by foreign countries is normally large and important. This demand is influenced by a number of factors, *e.g.*, domestic supplies which are affected by government bounties, quotas, embargoes, tariffs, preferential treaties with favored countries, and weather conditions; and the domestic demand which is influenced by political and economic conditions.

During the period 1909-1932 approximately 18 per cent of the agricultural income was derived from exports; during the same period only 5 per cent of our industrial income was derived from foreign sales. From 1925 to 1929, inclusive, 56 per cent of our cotton, 21 per cent of our wheat, 40 per cent of our tobacco, and 10 per cent of our pork production were sold abroad. The physical quantity of exports of agricultural commodities in 1933-1934 was 30 per cent less than in the years immediately preceding the depression. The proportion of our total exports enjoyed by the owner of agricultural products, however, increased from 36 per cent in 1929 to 43 per cent in 1933-1934. Thus the foreign sales of non-agricultural goods seem to have declined more, relatively, than those of agricultural products. The decline in the exports of agricultural products was concentrated largely in dairy products and grain and grain products. The exports of dairy products declined to one-fourth of the pre-depression figures, while the exports of grain and grain products declined to one-fifth of the earlier figure. The exports of cotton increased on a relative basis, while the exports of fruits and vegetables experienced only a slight decline. The foreign sales of live stock declined an amount equal to the average of all farm products.

The nature of our future agricultural exports, according to some estimates, will be changed from that existing in the pre-depression period. The exports of cotton and tobacco should retain their favorable position unless prices are raised so high through artificial control as to promote

foreign competition. Exports of fruits and vegetables are likely to expand. The foreign sales of grains and dairy and meat products, it is believed, are not likely to reach their former relative position.

Supply Factors.—Fundamental changes affecting the supply side also have been taking place. The use of power machinery has released millions of acres from the production of feed for horses and mules. The tractor, combine, and improved cultivating machinery are making possible a larger scale of production with lower unit costs. Improved methods of breeding and feeding make it possible to produce more meat and dairy products per ton of feed. More products per acre can now be produced under improved methods of cultivation, fertilization, and seeding. There are more than 6,000,000 independent farmers in the United States; almost 2,000,000 American growers are competing with each other in the cotton markets of the United States and of the world; almost 5,000,000 farmers are competing with each other in producing corn. It has been estimated that our present already too large farm output could be doubled if all the 505,000,000 acres classified as improved land were intensively cultivated.¹ This situation presents a serious problem in land utilization. The following quotation makes this point clear:

Improved farm income requires planned production and effective marketing. . . . Wise production planning must precede effective marketing. . . . The surest way to control an oppressive surplus is to prevent it. No marketing machinery can insure good prices and satisfactory income if the farmer plants and breeds unwisely. The day is past when farmers can safely plan on the basis of current or last year's prices or on guesses about the future. Planting and breeding operations should rest on the best possible size-up of the market outlook at home and abroad for a year or more to come.²

One of the committees appointed by President Roosevelt recommended in 1935 that 75,000,000 acres of sub-marginal land be retired from cultivation over a fifteen-year period. The government had secured options on 6,000,000 acres by the end of the first quarter of 1935. Much of the territory that suffered so extremely from the drought in 1934 should never have been used to grow wheat. The high prices during the war period were responsible for the unwise extension of cultivation in this region.

The land, live stock, and equipment used by the American farmer on January 1, 1918, had a value of approximately \$43,000,000,000; by

¹ According to the 1935 *Census of Agriculture* "all land in farms" amounted to 1,055,180,000 acres; the land and buildings had a value of \$32,884,342,378 compared with \$47,879,838,358 in 1930.

² Statement by Federal Farm Board, Jan. 29, 1930. Quoted in "The Agricultural Outlook for 1930," *U.S. Department of Agriculture, Miscellaneous Publication 78*.

January, 1920, the value had increased to \$78,436,000,000, the all-time peak; the value then declined to \$43,316,000,000 on January 1, 1932. His mortgage debt rose from \$3,320,470,000 in 1910 to a peak of \$9,468,526,000 in 1928, then declined slightly to \$9,241,390,000 in 1930 and to \$8,500,000,000 in 1932. The *total farm debt* was estimated to be \$12,000,000,000 in the last year; this debt was nearly three times the total gross farm income for 1932 and approximately equal to the income for 1929. The farmer's taxes were 55 cents on each hundred dollars valuation in 1913; these increased to \$1.50 by 1932. The farmer received 26.5 per cent of the national income in 1870, 20.5 per cent in 1900, 12.6 per cent in 1909, 12.5 per cent for the period 1921-1925, 10.7 per cent for the period 1926-1929, 7.8 per cent in 1932, and approximately 9.5 per cent in 1934. Agriculture has approximately 23 per cent of the gainfully employed people of the country and normally should receive about 14 per cent of the national income.

From 1929 to the spring of 1933 agricultural production in the United States declined only 6 per cent, but prices fell approximately 63 per cent. During the same period the production of motor vehicles dropped 80 per cent, tires 70 per cent, and steel products 83 per cent; but, because the production of these goods was brought more nearly in line with the effective demand, the price did not fall so far as that of agricultural products. The production of agriculture was approximately 15 per cent less during 1933 and 1934 than during 1929, while prices of farm products were about 40 per cent less than those of 1929; industrial production during the period was 40 per cent below the 1929 volume, but prices were only 15 per cent below. The Department of Agriculture estimated that there was a surplus of 50,000,000 acres capable of producing crops far in excess of market requirements. The 1920 *Census of Agriculture* reported 6,371,016 farms; the 1930 Census reported 6,288,648 farms; and the 1935 Census reported 6,812,049 farms, a substantial increase over the 1930 figure; the farm population was 30,257,000 in 1929 and 32,779,000 on Jan. 1, 1935—the largest in the nation's history. The increase was due largely to an excess of births over deaths. There was a decline in the migration from the cities to the farms during the year. It was found, for instance, that 783,000 people moved from the cities to the farms but 994,000 moved from the farms to the cities. A government report¹ states that this reverse movement "was probably the combined result of a farm housing shortage, somewhat better employment opportunities in non-agricultural industries, and the larger relief payments generally available to urban residents as contrasted to rural dwellers." The following table indicates the cash and imputed income of farmers and the amount remaining after the payment of expenses:

¹ Survey published by the Bureau of Agricultural Economics, May, 1935.

TABLE 36.—INCOME OF AGRICULTURE

Year	Total cash income ¹ and value of products consumed on the farm	Cash income ²	Net cash income after expenses ³
1919	\$17,000,000,000		
1920	13,500,000,000		
1921	9,000,000,000		
1923	The total cash income and imputed income varied between \$11,000,000,000 and \$12,000,000,000 during period 1923-1929		
1924		\$ 9,785,000,000	
1925		10,324,000,000	
1926		9,993,000,000	
1927		10,016,000,000	
1928		10,289,000,000	
1929		10,479,000,000	
	\$11,971,000,000		
1930	9,414,000,000	8,451,000,000	
1931	7,000,000,000	5,899,000,000	\$2,074,000,000
1932	5,333,000,000	4,328,000,000	1,463,000,000
1933	6,250,000,000	5,051,000,000	2,525,000,000
1934	7,500,000,000 (est.)	6,000,000,000	3,300,000,000
1935			

¹ WILSON, M. L., Assistant Secretary of Agriculture, *Nation's Business*, October, 1934. The revised estimate for 1934 issued in August, 1935, was \$7,300,000,000 including rental and benefit payments. Preliminary estimates for 1935 were \$7,630,000,000 plus \$480,000,000 benefit payments.

² From U.S. Department of Agriculture, *Yearbook* 1935.

³ Estimates by Brookmire Economic Service.

The wholesale value in 1929 of agricultural products used as raw materials was \$1,195,026,300; the value in 1933 was \$384,863,800, a decline of 67.3 per cent; the wholesale marketing expense was 2.9 per cent of the reported value for the former year and 4.7 per cent for 1933. The wholesale value in 1929 of agricultural products used as consumer goods was \$5,808,111,000; the value in 1933 was \$3,161,675,000, a decline of 45.6 per cent; the wholesale marketing expense for this group was 8.6 per cent in 1929 and 12.8 per cent in 1933.¹

The farm income during recent years, however, has not been an adequate return for the farmer's labor and invested capital. He has found himself at a relative disadvantage with other kinds of producers. The prices of agricultural products since 1928 have been low when compared with the prices of non-agricultural goods. The farmer's dollar would not buy so much as the dollar of the manufacturer or of the city laborer. The farmer, as a consequence, wants a greater control over money—he needs a larger money return for his labor and investment in land, machinery, and live stock. This means higher prices for his

¹ As reported by *Census of American Business*, 1933.

products or lower costs of production or perhaps both. While he may increase his income through higher prices, he needs to decrease his outgo by securing lower rates of interest, taxes, and transportation, and to reduce his capitalization, and his production and marketing costs.

The Agricultural Adjustment Act of 1933.—The conditions, briefly summarized above, constituted the background for the agricultural relief measures instituted in 1931. In 1933 the Agricultural Adjustment Act was passed.¹ The purpose of this Act was, in part, to increase agricultural prices and purchasing power, to raise revenue for extraordinary expenses incurred by reason of the emergency, and to provide emergency relief with respect to agricultural indebtedness.

One of the objectives of the A.A.A. was to raise the prices of agricultural products to "parity," i.e., the amounts per unit farmers must receive before their products will have as great an *exchange value* as they did in the "parity years" 1910–1914. The parity price on September 15, 1934, for wheat was \$1.09 per bushel; for cotton, 15 cents a pound; for butterfat, 31 cents a pound; for hogs, \$8.80 a hundred pounds; and for corn, 79 cents a bushel.

Crop-adjustment programs, so called, were the methods used in 1933–1935 to limit production. Farmers were asked in 1933 to plant only 85 per cent of their average acreage for the period 1928–1932; for 1934–1935 the limit was placed at 90 per cent of the base acreage. Hogs and cattle were slaughtered under government direction to reduce the surplus supplies and to increase prices. The cost was financed by processing and compensatory taxes. Rental and benefit payments totaling \$345,593,486 had been paid to cooperating farmers in the four major crops to October 1, 1934, by the A.A.A. Approximately \$108,000,000 additional, representing direct payments for hogs, cattle, and sheep, was given to farmers in the drought areas.² Processing taxes equaling \$495,366,429, including some minor taxes levied under the Adjustment Act, had been collected to the same date. Total payments for removal of surplus agricultural commodities from the drought areas equaled \$133,301,378. Direct payments amounting to \$108,000,000 were made to stock-owner farmers.

¹ This law and some other supporting legislation were declared unconstitutional during the early part of 1936.

² The government, in addition to making benefit payments, advanced money to farmers in the form of farm mortgage loans, short-term production loans, and loans to farmers' marketing and purchasing cooperatives. The total amount loaned in 1933 was \$737,000,000; in 1934 the amount increased to \$1,830,000,000, an amount equal on the average to \$5,000,000 for every day in the year. The laws and administrative orders affecting the marketing of agricultural products are being constantly changed. What the situation will be during 1936 and 1937 can only be guessed.

General Characteristics of the Supply Factors.—Agricultural products are by nature lacking in standardization and uniformity; they are more or less perishable and bulky. These goods are produced by millions of small-scale farmers scattered over wide areas. The producing area is limited by climatic conditions, fertility of the soil, topography of the land, and the presence of suitable transportation facilities for carrying the produce to the area of demand. The volume of production varies from season to season with weather conditions, the ravages of disease, and the attacks of insects.¹ The big fluctuations in production of grains due to weather and other conditions was what Secretary Wallace had in mind when he proposed the "ever normal granary." The purpose is to maintain a supply for emergencies that might arise. The acreage planted and the number of animals bred each year are determined, to a considerable extent, by the prices received during the preceding season and by the outlook for the coming season. The supply of agricultural products, with the exception of cattle, horses, and mules, is more elastic than the demand. Farming, generally speaking, is an industry affected with increasing costs or diminishing returns.

The Personal Element.—It appears, however, that supply tends to expand more readily than to contract. The farmer finds it more difficult to control the volume of production than the manufacturer. Farming is a method of *living* as well as a method of *making a living*. The farm is the home, a source of food, and it furnishes a "job." The owner has his investment in land, buildings, live stock, and various forms of equipment. The overhead, including interest on the investment, taxes, insurance, and depreciation, continues whether the farm is operated or not. Labor costs, excepting those of the farmer and his family, are usually small.

¹ The United States wheat production for 1933 and 1934 represents vividly this situation. The yield was the lowest in thirty-seven years owing to severe adverse weather conditions. The winter wheat-crop yield was estimated at 340,000,000 bushels against a five-year average of 590,000,000 bushels, and the spring wheat-crop yield at 174,000,000 bushels against a five-year average of 271,000,000 bushels. The carryover from the preceding year, however, was 386,000,000 bushels, the greatest in the history of the country. The total supply of wheat in the United States for 1933 was estimated at 900,000,000 bushels, as compared with 1,100,000,000 bushels in the preceding year. Domestic consumption for the 1932-1933 season was estimated at 685,000,000 bushels. A large quantity was fed to animals owing to the low price and abundant supply. Prices went below 50 cents a bushel during the latter part of 1932 and the first part of 1933. The drought of 1934 plus the reducing program of the A.A.A. changed the situation so rapidly that we had to go on an import basis with prices so high in this country that some agricultural products came in over the high tariffs. The wheat stocks reported on farms as of April 1, 1933, were 183,000,000 bushels; by April 1, 1934, they had fallen to 116,000,000 bushels; and by 1935 they had reached the low figure of only 94,000,000 bushels. The spring wheat crop for 1935 was smaller than expected, owing to the rust.

The result is that the farmer continues to operate even though he does not earn a living wage, in the hope that the returns will be satisfactory "next year." Such factors as the weather, insects, and disease always make any attempt at control uncertain. The large number of widely distributed farmers make concerted action difficult to secure. It is possible, however, that through a more scientific study of land utilization, through forecasting of consumer and industrial demands, and through cooperative organization and practice farming may be brought to a fair degree of stabilization.

The following quotation summarizes in an effective manner the more important personal characteristics of the farmer and lists some of the peculiarities of his business problems.¹

. . . The farmer, leaving his job, also leaves his home. His job and his home are together. Farming is a way of living as well as a way of making a living. The factory worker's home and job are separate. He can change his job without changing his home, or he can move even from one city to another by leaving one apartment and going to another. I do not minimize the difficulty for the city worker in this, and I do not wish to minimize the amount of it. But it is certainly nothing like so grave a problem as the farmer faces if he must abandon his home and his job. The training of the farmer is a far more complicated thing than the training of the factory worker. With modern mechanized production and mass production, with the minute subdivision of labor, a few months is usually sufficient for the mastery of the workman's factory job.

The mastery of farming, however, is a matter of many years. The farmer is a business man as well as a laborer. He must know markets, both on the buying side and on the selling side. He must know how to deal with banks. He must know soils and seasons. He must know farm machinery and how to keep it in good order. He must know how to judge livestock and he must know the particular purposes for which one breed has advantages over another—what breeds, for example, will take on weight in the form of porterhouse and sirloin instead of breast plate. He must know fruits and poultry.

The farmer, moreover, is not a solitary worker. The farmer and his family together work the farm. The farm and the farm family have grown together. The same family would not do so well on another piece of land, the peculiarities of which they do not know, and into the life of which they have not grown. The city worker, shifting from one factory to another, or even from one factory town to another, is still in a familiar environment. The farmer, however, who must shift from country to city, is going into a very unfamiliar environment.

-The farmer as a class has been conservative. He has gloried in his independence and resented, if not regarded with suspicion, attempts to get him into some form of organization. The typical American farmer is intelligent, shrewd, energetic, and thrifty. The agricultural colleges, farm papers, and county agents have done much to spread sound technical

¹ From *Vital Speeches of the Day*, p. 283, Jan. 28, 1935.

information in the rural communities. Recently a large portion of the farmers has become more progressive and even aggressive. The cooperative movement is being regarded with a more sympathetic attitude. The alert farmer has come to regard himself as a business man; he is beginning to think in terms of producing for the market and not merely of disposing of a small surplus, the excess above his own personal needs. He was, however, somewhat confused and startled when he finally grasped the full significance of the policies and practices of the A.A.A. It was the first time he had ever received "something for nothing," i.e., benefit payments for *not* working.

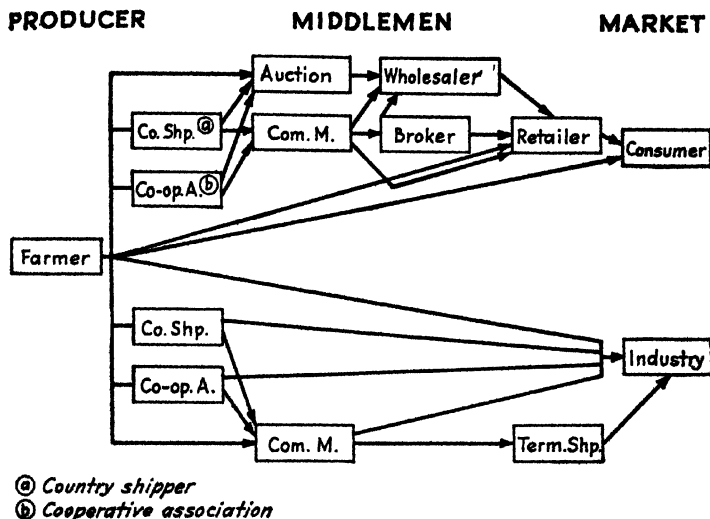


CHART VII.—The marketing of farm products

Services, Agencies, and Methods.—The method of producing agricultural products makes collecting necessary. The typical farmer does not produce in large enough quantities to secure the benefit of carload freight rates. The local shipper, the cooperative association, and other agencies have been developed to perform this function. The distance of the producing areas from the consuming areas and the bulkiness and perishability of the product give rise to difficult problems of transportation, storage, risk bearing, and financing. The lack of uniformity as to size, quality, and the other attributes regarded as important by the buyer makes necessary the establishment of standards and grades. The small volume of sales at any given time, the distance from the consumer, and the lack of adequate market information and of familiarity with market organization and practice make it necessary for the individual farmer to turn over to various middlemen (see Chart VII) the marketing

of the major output of agricultural products. He may sell directly to the consumer or industry, indirectly through the various middlemen, or by means of the cooperative association.

Our study of the principal problems met in the marketing of farm products is simplified by classifying them under the two major headings, crops and animal products. Each group is further divided so as to secure some of the advantages of specialized treatment while eliminating some of the disadvantages of tiresome repetition.

CLASSIFICATION OF AGRICULTURAL PRODUCTS

1. Farm crops:

- a. Grains, *e.g.*, wheat, corn, oats, rye, barley, rice, broom corn.
- b. Fruits and vegetables, *e.g.*, citrus fruit, bananas, apples, peaches, berries, potatoes, tomatoes, lettuce, melons.
- c. Fibers, *e.g.*, cotton, flax, hemp, jute.
- d. Miscellaneous, *e.g.*, rubber, sugar, tea, coffee, copra, cacao, tobacco.

2. Animal products:

- a. Live stock, *e.g.*, hogs, cattle, sheep, horses, mules, poultry.
- b. Products derived from farm animals, *e.g.*, milk, butter, cheese, eggs, silk, wool, mohair, honey.

The Marketing of Farm Crops.—Farm crops are those agricultural products that result from the cultivation of the soil. These fruits of the land may be produced on small truck farms adjacent to great industrial centers, on large grain farms found hundreds of miles from the central markets, or on mammoth plantations and ranches thousands of miles from the major points of consumption.

There are, in addition to the specialized types of farmers, thousands of agriculturalists engaged in mixed farming. That is, they produce several of the following: wheat, corn, potatoes, cotton, tobacco; own a fair-sized orchard, some poultry, a herd of hogs, some dairy cows, a flock of sheep or, perhaps, they may be feeding a number of steers.

The map facing page 284 was prepared by the planning division of the A.A.A. to indicate the locations of the various types of farming in the United States. The 13 regions and 100 sub-regions are differentiated on the following bases: "relative variations in soil, climate and surface features; crops and livestock combinations; relative productivity; markets; relative income by source; and other minor factors."

The economic and social importance of the *farm-crop* group of agricultural products is indicated by Table 37, which gives the dollar value of farm crops for the nine-year period 1926-1934.

The income was fairly stable for the years 1926-1929, inclusive. There were extreme fluctuations for the years 1930-1933, inclusive, which adversely affected the purchasing power and the standard of living of large numbers of farmers.

F FARMING

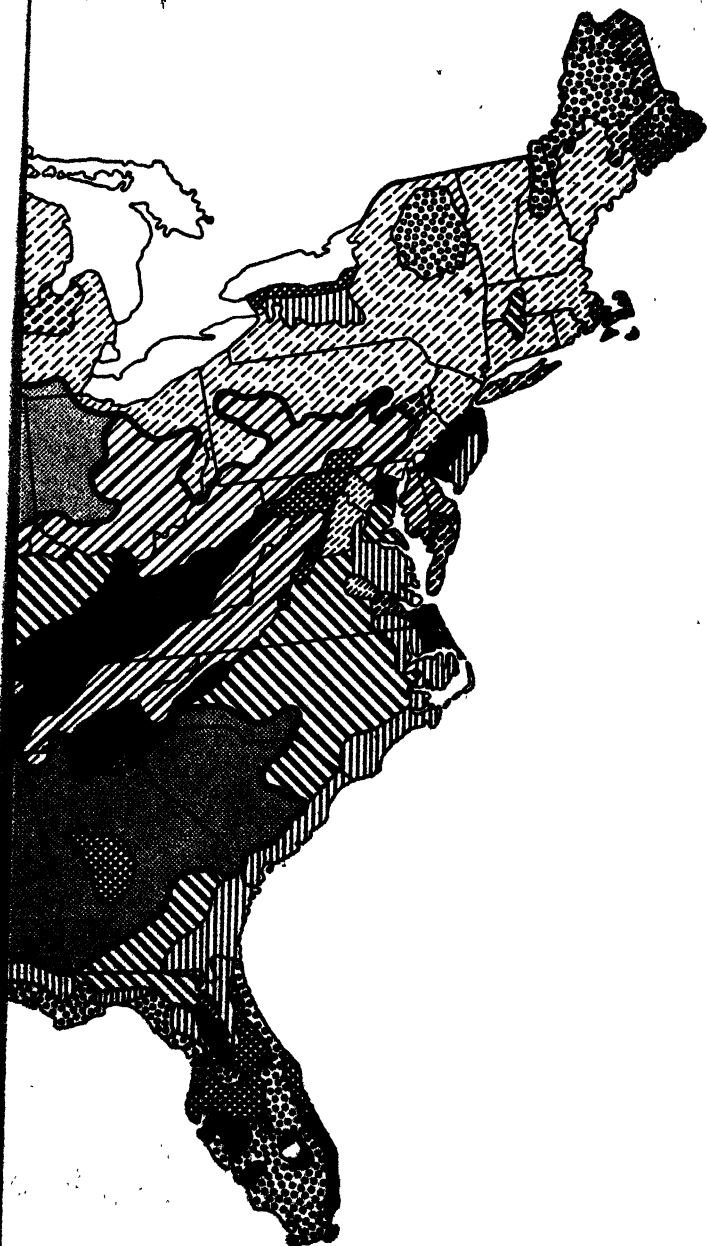


TABLE 37.—GROSS INCOME FROM FARM CROPS, 1926-1934¹

Year	Dollar Value
1926	5,468,000,000
1927	5,817,000,000
1928	5,675,000,000
1929	5,421,000,000
1930	3,799,000,000
1931	2,748,000,000
1932	2,290,000,000
1933	2,876,880,000*
1934	4,782,626,000 (est.)
1935	

¹ U.S. Department of Agriculture, Yearbook 1935, p. 671.

* The figure for 1933 does not include \$271,024,000 benefit payment on wheat, cotton, and tobacco

Rather than analyze the marketing process for each crop coming from the farm, we shall, in most instances, select a typical product from the major groups, *e.g.*, wheat to represent the grains, cotton to represent the fibers, and coffee to represent the miscellaneous group. Fruits and vegetables are discussed as a group.

Marketing of Grains.—The grains, especially wheat, rye, barley, oats, rice, and corn, are an important source of income for large numbers of farmers throughout the greater portion of the United States. Geographic sections tend to specialize in the production of certain grains. Thus we have what are called the corn belt, the cotton belt, and the wheat belt. The last is divided into the winter and the spring wheat regions. There are many states in which several of the grains can be profitably produced. Corn, wheat, oats, rye and barley, for example, *can* be grown in a large number of states in the Mississippi Valley. There is a decided tendency, however, for the farmers to concentrate on the particular crop which offers the best chance for a satisfactory return. The economic importance of the grains is indicated by Table 38. The grains supplied 12.6 per cent of the average total farm income during the period 1924-1930. They accounted for only 9.8 per cent of the 1933 farm income. This reflects the big decline in *prices of grains like wheat.*

TABLE 38.—FARM INCOME RECEIVED FROM GRAINS¹

Year	Amount
1927	\$1,302,000,000
1928	1,518,000,000
1929	1,297,000,000
1930	1,000,000,000
1931	600,000,000
1932	450,000,000
1933	300,000,000
1934	
1935	

MARKETING AGRICULTURAL PRODUCTS—FARM CROPS 281

TABLE 37.—GROSS INCOME FROM FARM CROPS, 1926-1934¹

Year	Dollar Value
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1927	5,817,000,000
1928	5,675,000,000
1929	5,421,000,000
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TABLE 38.—FARM INCOME RECEIVED FROM GRAINS¹

Year	Amount
1927	\$1,592,000,000
1928	1,513,000,000
1929	1,297,000,000
1930	806,000,000
1931	488,000,000
1932	450,000,000
1933	506,000,000
1934	
1935	

¹ *Ibid.* The preliminary estimate for 1935 was \$700,000,000 plus \$239,000,000 in benefit payments, a total of \$939,000,000.

The steady decline in the income derived from grain during the period 1927-1932 reflects the unsatisfactory relation existing between supply and demand. Since wheat is grown for market by such a large number of farmers scattered throughout such a wide area, we shall use it to illustrate the marketing process applied to the grains. While the size of the corn crop, measured in bushels, is enormous, a relatively small proportion is sold in the raw state.¹ The major portion of the corn crop is fed to hogs, cattle, and other animals on the farm and "marketed on the hoof."

Characteristics of the Demand Factors for Wheat.—Wheat is purchased on a large scale by manufacturing concerns which use it as a raw material.

TABLE 39.—UNITED STATES DEMAND FOR WHEAT¹
(1,000 bushels)

Crop year beginning July	U.S. production	Carryover (including flour) June 30	Imports	Exports	Seed	Disappearance for food, feed, and loss	Weighted average price received by producer, cents
1920-1921	843,277	101,143	57,682	373,003	88,408	458,292	182.6
1925-1926	669,142	114,703	15,679	111,089	79,540	502,805	143.7
1926-1927	833,544	131,423	13,264	222,340	85,065	522,683	121.7
1927-1928	874,733	132,884	15,734	209,002	91,416	588,588	119.0
1928-1929	912,961	260,266	21,442	166,914	84,577	555,530	99.8
1929-1930	822,180	311,458	12,956	156,294	83,930	543,720	103.4
1930-1931	889,702	332,846	19,059	134,345	81,060	684,468	67.0
1931-1932	932,221	391,605	12,886	139,458	80,098	666,792	39.0
1932-1933	745,788	400,505	9,382	44,690	82,922	618,658	37.9
1933-1934	528,975	295,799	11,494	39,801	76,181	529,193	74.1
1934-1935	496,469	290,000 (est.)*	.....	.....	75,476	.....	88.0
1935-1936	550,000 (est.)*	155,000 (est.)*	.....	.....	.....	.....	.....
Average U.S. annual production 1927-1931—886,359						Average annual domestic consumption approximately 625,000	

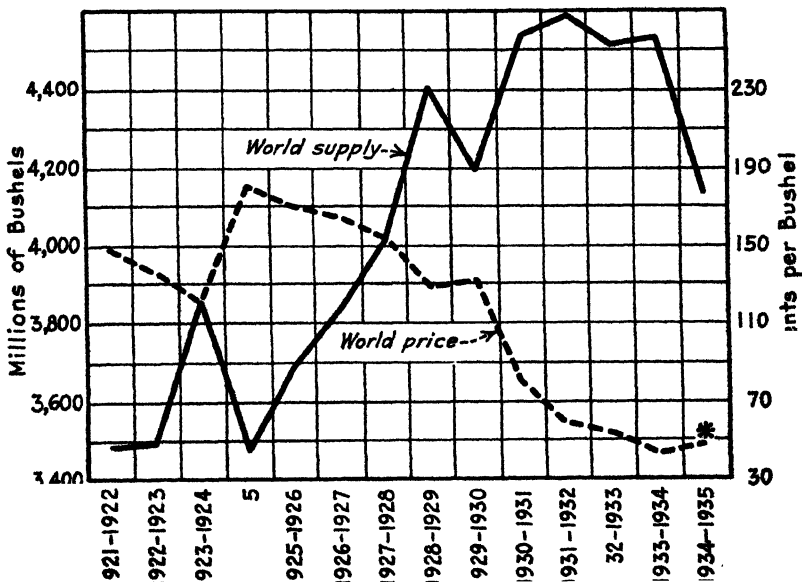
¹ Compiled from *U.S. Department of Agriculture, Yearbook of Agriculture, 1935*, pp. 399, 402

* Preliminary estimates published in newspapers.

It is used largely for the purpose of producing bread and pastry flours, breakfast cereals, spaghetti, macaroni, vermicelli, and other similar products. Some of these products require different varieties of grain, such as durum, hard red wheat, soft winter wheat, and white wheat.

¹ The 1933 crop was estimated at 2,344,000,000 bushels. This huge amount, however, was 45.5 per cent below the five-year average. The 1934 crop of 1,372,000,000 bushels was 41.5 per cent below the 1933 yield and was the smallest crop since 1851. The declines for the two years were due to the droughts and the A.A.A.

The general demand for wheat in the United States during the period 1920-1934 is indicated in Table 39. The importance of the foreign demand until 1932-1933 is clearly shown. There had been, as the table shows, a drastic decline in this demand from 1920 to 1929. The year 1925-1926, however, marked the lowest point for exports until 1932-1933. This was due, however, to a small crop in the United States and to the high prices resulting. The annual domestic demand (indicated in the columns headed Disappearance for food, feed, and loss, and seed) for wheat seems to be approximately 625,000,000 bushels for consumption plus about 80,000,000 to 85,000,000 bushels for seed. Any excess production above this amount normally must find a foreign outlet. It



* Average, July 1 to Nov. 30, 1934, in terms of gold.

CHART VIII.—Relation between the world supply and the world price of wheat.¹

was not until 1933 that our production fell below our domestic requirements. The strength of the demand in relation to the available supply during the period is indicated in the column headed Weighted average price received by producer. The price for 1925-1926 accurately reflects the short crop for that year, while the prices received during subsequent years just as vividly reflect the excess production until the droughts of 1933 and 1934 and the activity of the A.A.A. so drastically reduced production. Chart VIII indicates the relationship existing, under more or less normal market conditions, between world supply of wheat and price.

¹ From "Facts about Wheat," published by the A.A.A., 1935.

Wheat is said to have a world market. It is used extensively in North and South America and in Europe. Since wheat is manufactured into a staple food product, the demand tends to be inelastic, stable, and continuous. There is no appreciable seasonal, secular, or cyclical element present. The demand has grown with the development of industrial centers and the spread of western civilization. Wheat finds a strong competitor in rice in the Far East and in rye in certain sections of Europe. The United States consumes normally about 75 per cent of its own production for seed and manufacturing purposes; approximately 60 per cent of the total crop goes out of the country where produced. Approximately 25 per cent was normally exported before 1930; the foreign sales were made chiefly to European countries.

The per capita consumption of wheat in the United States, apparently, has been declining for at least fifty years. The per capita consumption of wheat flour originally was about 226 pounds; in 1914 it was 209 pounds; in 1919 it was 198 pounds; in 1921 it was 176 pounds.¹ This decline is probably due to changed living and eating habits and customs. A short wheat crop in Argentina, Australia, or Canada greatly increases the demand for the wheat of the United States.

How the foreign demand for wheat was affected by political action may be illustrated by the practice followed in France. The general tariff on wheat was raised from 19.6 cents a bushel in 1927 to \$1.71 a bushel in 1933.² French millers normally used 30 per cent of foreign hard wheat to mix with the native soft wheat. The government, however, established quotas which reduced the amount to 3 per cent, then to 1 per cent, and, finally, in 1933 an emergency measure was passed which permitted none. These drastic actions by the French government were taken to reduce their own surplus which had developed because of their practice of fixing prices to be paid their own farmers. The price of wheat, for example, was \$2.38 a bushel on August 1, 1934, when Argentine wheat was selling in Liverpool at approximately 75 cents a bushel. The plan, which placed no restriction on production, of course, only led the farmers to increase production, thereby intensifying the emergency.³

The Supply Factors.—Wheat is relatively non-perishable when certain simple precautions are taken. The greatest risks of loss come from water and vermin. Compared with many agricultural products, wheat is not bulky. A 1,500-bushel carload of wheat at \$1.20 a bushel repre-

¹ The average per capita consumption of cereal products was 228 pounds for the period 1920-1924, 229 pounds for 1925-1929, 221 pounds for 1930-1933, and 226 pounds for the entire period 1920-1933. *Regional Problems, op. cit.*, p. 8.

² The tariff in Germany was reported as \$3.85 a bushel in 1934; in Italy, \$1.75 a bushel.

³ *Economic Conditions*, National City Bank, January, 1935.

sents a value of \$1,800. The variety of wheat, *i.e.*, hard red spring, durum, white, hard red winter, or soft red winter wheat,¹ is controlled by the producer in his choice of seed. The quality, however, depends so much upon the forces of nature that the crop when harvested may represent several different grades. It is necessary, therefore, to grade the grain to meet the needs of the market.

Wheat is grown as an independent product, sold in bulk according to grade, and is unidentified as to producer. The superiority of wheat as a source of flours for bread, pastries, and similar food products is so great that there are no serious substitutes in the great consuming areas.

TABLE 40.—WHEAT SUPPLY¹
(Millions of bushels)

Crop year	World production excluding China	U.S.	Canada	France	Russia	India	Argentina	Australia
1910-1911	3,613	635	132	253	836	360	146	95
1915-1916	4,324	1,026	394	223	827	377	169	179
1920-1921	3,288	843	263	237	320	378	156	146
1925-1926	4,165	669	395	330	785	331	191	115
1926-1927	4,409	834	407	232	914	325	230	161
1927-1928	4,468	875	480	276	797	335	282	118
1928-1929	4,800	913	567	281	807	291	349	160
1929-1930	4,264	822	305	337	694	321	163	127
1930-1931	4,836	890	421	228	989	391	232	214
1931-1932	4,608	932	321	264	786	347	220	191
1932-1933	4,557	744	443	334	744	337	241	214
1933-1934	4,692	529	270	362	1,019	353	286	175
1934-1935 (prelim.)	3,423*	496	275	332	.....	349	252	137
1934-1935	.....	550†						

¹ Adapted from *U.S. Department of Agriculture, Yearbook 1935*.

* The Russian production is not available for 1934-1935.

† Preliminary estimates published in the newspapers.

The products manufactured from wheat are, generally speaking, regarded as necessities.

The world supply of wheat is indicated in Table 40. China is omitted from the table because reliable statistics are not available. The big

¹ For a description of the various classes of wheat consult *U.S. Department of Agriculture, Yearbook 1921*, pp. 122 ff.

Our exports of wheat and flour declined from an annual average for the period 1925-1929 of 192,000,000 bushels to an average of only 39,000,000 bushels for 1932-1934; all grains, other than wheat declined from an annual average of 2,784,000 tons to only 522,000 tons for the same periods. During the first seven months of 1935 the United States imported \$40,893,906 worth of grain of all kinds and 714,104 pounds of wheat flour; more than 23,000,000 bushels of corn were imported during the same period.

production of Russia is relatively unimportant at present from a marketing point of view. This country enjoyed a phenomenal increase in production in 1933-1934. The United States is second only to Russia in volume of production. The United States is not, however, so important as a source of supply for foreign countries as Canada, Argentina, and Australia. This is due to the fact that our ever-increasing population consumes so much of our domestic production. We, in fact, import under normal conditions substantial amounts of special kinds and grades of wheat for blending purposes. The effect of the war stimulation on production in the United States is reflected in the big output for 1915-1916. Production in the European countries increased, according to some estimates, by more than 350,000,000 bushels from 1927 to 1933, while consumption declined 200,000,000 bushels.

The Method of Production.—A large volume of wheat is produced under small-scale methods by millions of farmers in Western Europe and Russia, North America, Argentina, Southeastern Asia, and Australia.

The post-war development of the tractor, power combine, and seeding machinery that will seed 125 acres a day has made possible a scale of production not dreamed of only a few years ago. The production period varies from ten months in the case of winter wheat to five months for spring wheat. The winter wheat crop of the United States is harvested in the summer. While wheat is harvested some place on the earth's surface almost every month in the year, the production for any given section is highly seasonal. The wide geographical distribution of the producing areas and their distance from the consuming centers, as well as the seasonal element in production, make an elaborate organization for concentrating, transporting, storing, financing, and risk bearing necessary.

Increased production at a lower unit cost through the addition of successive units of labor and capital to a given number of acres of land has serious limitations. European countries have been able to increase the number of bushels grown on an acre by the use of commercial fertilizers and intensive methods of cultivation. Their increased cost of production is partially offset by their nearness to the consumer market and the high transportation costs paid by the grain coming from the virgin lands in the less densely populated regions of the world where an extensive method of cultivation is practiced. The tariffs, bounties, and quotas also aid the European farmers in overcoming the handicap of higher costs of production.

The Producer.—The wheat grower as a producer has shown, recently, a high degree of progressiveness in his willingness to adopt improved methods of production. He has an independent attitude in dealing with political, social, and economic problems. It is only recently that he

has begun to evince a friendly attitude toward the cooperative movement. The wheat farmer is forced to operate under great handicaps. When he sows his grain, he does not know how many acres other wheat farmers are sowing; neither does he know what the weather will be and how it will affect the final yield. He is not familiar with marketing practice, and usually he does not possess enough market information to form a sound judgment as to when is the best time to sell. His time is so taken up with production problems that he has, in the past, given little thought to the problems of marketing. Many farmers, because of their limited financial resources, find it necessary to sell the grain as soon as it is harvested so as to pay off their current obligations. The development of the cooperative association seems to offer a way out of some of these difficulties.

The accumulation of large surpluses and the declining demand from foreign countries led the federal government in 1933 to propose a plan, to be administered on a cooperative basis, for reducing the wheat surplus and to raise the price. Almost 800,000 wheat producers operating approximately 577,254 farms¹ were organized into 1,328 voluntary cooperative associations. The average number of acres seeded to wheat during the three-year period 1930-1932 was about 66,000,000. Domestic needs could be supplied, according to estimates made by the A.A.A., from 50,000,000 acres. The then-existing foreign demand could be supplied from 6,000,000 to 8,000,000 additional acres. The plan finally worked out and agreed upon called for a reduction in wheat acreage. The objective was to adjust the supply of wheat to the demand. The essential features of the program, as it was finally established, were

(1) A return on that portion of the crop needed for domestic human consumption which will give that portion the exchange value it had in the pre-war period 1909-14. This portion has been found to be 54 per cent of the average production during the base period 1928-32.

(2) Agreement of cooperating growers to regulate plantings within limits determined by the Secretary of Agriculture. These limits are designed to provide for domestic needs, adequate reserves, and any likely export demands.

(3) Provision that each cooperating grower should plant at least 54 per cent of his average past acreage, this amount being deemed necessary, with average yields, to meet domestic food requirements.

(4) Financing of the program through a processing tax on the wheat milled for domestic consumption.

(5) Voluntary acceptance of the plan by farmers.

(6) Benefit payments made to cooperating farmers independent of the market proceeds from the sale of their crop, thus providing partial crop-income insurance.

(7) Decentralized administration through county wheat associations.

¹ In 1929, 1,208,091 farms were growing wheat; many of them were small and widely scattered.

(8) Coordination of the domestic program so far as possible with the International Wheat Agreement.

The average total acreage seeded to wheat in the United States in the period 1930-32 was 65,958,000 acres. Of this area 78 per cent, or 51,400,000 acres, was brought under contract. Growers were authorized to plant, for the 1934 crop, 85 per cent of the base acreage,¹ or 43,690,000 acres. The acreage authorized for the 1935 crop was increased to 90 per cent of the base acreage, or 46,260,000 acres.²

Total adjustment payments on the 1933 crop amounted to about \$98,600,000 and it was estimated that the wheat growers received about \$101,600,000 on the 1934 crop. This represents a payment of 29 cents a bushel on farm allotments totaling 350,345,000 bushels. The farmers of South Dakota received only \$316,000 in cash from the sale of their wheat in 1933, but they received about \$5,000,000 in benefit payments, or sixteen times as much cash as they received from the sale of their wheat. A number of other states benefited greatly from payments made pursuant to the 1934 drought.

The plan is financed by a processing tax of 30 cents a bushel on the milling of wheat. This tax was in effect from July 9, 1933 to January 6, 1936, when the act was declared unconstitutional. The revenues collected to June 30, 1934, amounted to approximately \$117,621,000. The amount of the tax was determined by the Secretary of Agriculture on the basis of what he thought was necessary to bring the price of wheat to parity or to its fair exchange value.

Methods of Selling Wheat.—The major portion of the wheat crop is sold either by the indirect method or through cooperative associations. A comparatively small portion is sold direct by the farmer to millers, feeders, and retailers. The typical method is for the grower to sell to an elevator³ located in a near-by town. The local elevator sells, through commission men located in the central markets, to millers, exporters, speculators, and wholesale wheat merchants.

The farmer may sell his grain at harvest time, or he may think that prices will advance later and so decide to store his crop.⁴ He may store the wheat on the farm if he has suitable space and does not have

¹ The "base acreage" apparently was 51,400,000 acres. This is not made quite clear in the quotation. The plan was changed in 1935 so as to permit the farmers to seed 95 per cent of the base acreage for the crop year 1935-1936.

² "The Facts about Wheat," Agricultural Adjustment Administration, *Commodity Information Ser.*, pp. 4 ff., 1935.

³ The farmer may sell also to buyers sent out by the large terminal elevator companies, so-called track buyers, and to scoop shovelers.

⁴ The farmer of the Pacific Northwest frequently stores his wheat at harvest in the local elevator and sells later. The wheat grower of the Central West more frequently sells at the time of thrashing or stores on the farm.

time when he thrashes to transport it to the local market. Frequently, however, the grain is hauled to the local elevator where it is graded, measured, and stored at the rate of $\frac{1}{2}$ to 1 cent a bushel per month. The farmer can then sell whenever he desires. He retains, during the storage period, the risks incident to changes in price.

The Services Necessary and the Agencies That Perform Them.—Wheat, when bought by the local elevator, is inspected, graded, weighed, priced, paid for, stored, and perhaps cleaned, conditioned, and mixed, and later loaded into box cars and shipped to some terminal market or export point.

Wheat, as it comes from the farm, usually lacks uniformity in quality, so it must be inspected by the purchaser to determine its condition. It may be chaffy, damp, musty, contain much dockage, or be infested with vermin. There are six classes of wheat: durum, hard red spring, hard red winter, soft red winter, common white, and white club. When one of the classes has more than 10 per cent of another mixed with it, it is designated as mixed wheat. The hard wheats have sub-classes based on color and texture of kernels, *i.e.*, whether they are dark, hard and vitreous, or yellow, mottled, and starchy.

More and more weight is now being given to the protein content since specialized bakers are willing to pay a premium for wheat having a high protein content.

Each sub-class of wheat is divided into grades designated as No. 1, 2, 3, 4, and 5. The particular grade of any given sample depends upon the test weight per bushel, moisture content, percentage of damaged kernels, cleanliness, and condition.

Wheat may be inspected at designated concentration points or at terminal markets. The inspectors are hired by boards of trade, chambers of commerce, and the grain-inspection departments of some of the states. They are licensed by the U.S. Department of Agriculture and use the federal standards. When a carload of grain arrives in the central market, it is put on the "sampling tracks." The samplers, working under the direction of a yard foreman, visit the cars and take representative samples by which the grade is determined.

The price received by the farmer from the local buyer is the result of a certain amount of bargaining. The alert farmer is very much interested in the testing of his wheat to determine the grade, amount of dockage, and the net weight. The price he finally receives tends to be the terminal market price for the same grade *less* the cost of transportation to the terminal market *plus* the gross margin of the local buyer. The gross margin includes the profit of the buyer and all of his operating expenses, such as labor, cost of operating the machinery, interest on his investment, depreciation, taxes, and insurance.

The local grain merchant may hold the grain in his elevator, waiting for an increase in price,¹ sell it immediately in the central market, or sell contracts for future delivery on the board of trade and thus reduce his risk of loss from a fall in price before he can ship his purchases to the central market. When he sends the grain to the central market, he may sell it *on consignment* through a commission house or sell it *direct* to a merchant or manufacturer.

Grain received on consignment is offered for cash sale on the basis of official samples displayed on the floor of the grain exchange. The so-called grain commission merchant is in reality an agent of the country shipper and does not take title to the product. The services performed by this agent, however, may be quite extensive. He may help finance the seller by advancing a large proportion of the payment before the wheat is actually sold; he may buy and sell futures to protect his client; he may supply valuable market information; arrange for cleaning and conditioning the wheat in the central market; and see to it that his client receives fair treatment with reference to inspection, grading, and weighing. The commission house secures its business from the local shippers through mail and personal solicitation, offers of liberal financial assistance, and by furnishing prompt and special market information.

The country shipper sells much grain directly to the terminal elevator companies.² These firms constitute an important factor in our marketing organization and perform valuable services. Since wheat is harvested in the United States during only a few months of the year and is consumed throughout the year, the performance of the storage function is necessary. The aggregate storage capacity of commercial elevators at the major terminal markets is reported to be in excess of 260,000,000 bushels. Approximately 35 per cent of this capacity is owned by the railroads, while 80 per cent of the space is operated by private dealers in grain.³ Other services performed by the terminal elevator are the

¹ Because of the lack of storage capacity, especially during the harvest season, and uncertain financial resources, the typical merchant has to keep his grain moving toward the central market.

² The wheat may be sold, on the basis of grade, f.o.b. cars at country station. That is, the carload is bought "on track," the purchaser to pay the cost of transportation to the terminal market and to assume the risks of ownership. Another way of selling is the "to arrive" sale. Under this method of sale the seller pays the transportation costs.

³ There are, in addition to the commission merchants and the large elevator companies, two other rather important middlemen in the terminal market: (1) the *independent shippers*, who buy from commission men and terminal elevator companies and sell to mills, manufacturers, and exporters; (2) the *cash grain broker*, who buys on orders from millers, converters, exporters, and others; or he may aid the elevators, commission men, and others in finding suitable buyers for their commitments. His primary function is to bring buyer and seller together. He has nothing to do with the handling of the grain and assumes none of the risks involved in making payment and delivery.

transferring of grain from one transportation vehicle to another—as from a car to an elevator, then to a ship or car for further transportation; cleaning and conditioning the grain, *i.e.*, drying, bleaching, cooling, screening, and mixing. Mixing may be practiced to meet the needs of the millers or to combine a small portion of high-grade wheat with a large portion of lower grade so as to produce a grade that will sell at a greater profit.

The movement of grain from the farm to the terminal elevator is a part of the *concentration* process. The flow of grain out of the terminal market to the final points of manufacture is the beginning of the *dispersion* process. The large elevator companies sell their grain to the millers, exporters, and foreign importers. While the development of cooperative marketing will not change the kind of services to be performed, integration will bring about some changes in the type and the grouping of the functionaries that perform the services.¹

Wheat Market Centers.—The largest flour milling center in the United States in 1934 was Wichita, Kans., and the second was Buffalo, N.Y. Liverpool, under normal conditions, is the price-determining wheat market of the world. The Chicago market is the leading market in the United States. The Chicago price normally is 15 to 20 cents below the Liverpool price. The Chicago prices, however, have been above Liverpool since February, 1933. On October 15, 1934, the Liverpool price was 72 cents, while the Chicago price was 88.5 cents. Under normal relationships the Chicago price would have been about 60 cents a bushel.

Who Pays a Processing Tax?—According to some estimates, the processing tax on wheat resulted in a 5 per cent increase in the price of bread. The per capita burden was somewhat less than \$1 a year; for a family of four this would amount to between \$3 and \$4 a year. Who pays a processing tax depends, to a considerable extent, upon market conditions. When there are extensive surpluses the tax is quite probably paid by the farmer in the form of lower prices received for his products. When there is a deficiency in supplies, the consumer quite probably bears the major burden of the tax. If and when the retail price reaches a point where the consumer reduces his purchases of the particular commodity and begins to substitute other products, the volume of sales remains stationary or declines. Under such conditions the burden may be distributed in some unknown and probably constantly changing proportion among producers, processors, and consumers. The wheat tax was of material benefit to the farmers who received the proceeds. The objection is that it was a form of sales tax and was regressive in effect, *i.e.*, it fell with greater force on the low-income group than on the higher

¹ For a discussion of marketing agricultural products by Farmers' Cooperative Organizations, see Chap. XIX.

income group because the tax was based on the consumption of necessities rather than on ability to pay.

Costs of Marketing Wheat.—The farmer receives, according to the Federal Trade Commission, 77 per cent of the price paid by the miller for the wheat and 13 per cent of the price paid by the consumer to the baker for the bread made from the flour of the wheat. The spread between the price per bushel received by the farmer from the country elevator and that paid by the miller to the terminal market middlemen is indicated by the following Federal Trade Commission figures:

TABLE 41.—COSTS OF MARKETING WHEAT

Cost items	Five-year average 1912-1913 to 1916-1917, cents	1919-1920, cents
Middlemen:		
Country elevator margin.....	6.05	11.93
Terminal elevator margin.....	7.58	6.96
Transportation costs.....	11.08	14.31
Total.....	24.71	33.20

The cost of marketing Canadian wheat by the wheat pool in 1931 equaled approximately the price received by the grower from the country elevator. The Liverpool price was 74 cents a bushel; the cost of moving the wheat from the country buyer who paid the grower 37.75 cents a bushel was 36.25 cents a bushel. The transportation costs alone accounted for almost fifteen-sixteenths of the total farm cost.

The Major Problem.—The major problem met in marketing wheat results from the uncertainty of the volume of supply. The millions of widely scattered small-scale producers make concerted action with reference to control of production extremely difficult, if not impossible. The influence of weather conditions and insects upon the volume and quality of the product finally harvested presents another serious difficulty. Long-term weather forecasting, if and when it becomes reliable, offers some hope. Since the demand for wheat is comparatively inelastic, the price paid to the farmer varies widely with the amount of production. It has been estimated that a world wheat crop 10 per cent below normal raises the Liverpool price 11 to 15 per cent, while a world crop 10 per cent above normal depresses these prices 9 to 12 per cent. A wider variation from the normal in the volume of production would probably cause a much greater variation in price. During the crop year 1924-1925

the relatively small world supply of only 3,500,000,000 bushels sold at an average price of \$1.76 a bushel. The 1931 crop equaled approximately 4,500,000,000 bushels and brought an average price of only 54 cents a bushel. This low price was due to a combination of adverse factors, *viz.*, excess supplies, depressed business conditions, and chaotic international trade relations.

The determination of the best time to sell is an important administrative problem. The common practice is for farmers to sell their grain at harvest time; when prices appear weak, there is a tendency to rush the wheat to market before the price goes lower. "Orderly marketing" has been advocated as a remedy for this difficulty. This plan, if it could be effectively administered, would prevent gluts and distress selling. The expected benefits from orderly marketing in any one country, however, may be nullified by "disorderly" marketing in other parts of the world.

The rapid growth of cooperative associations¹ under government leadership promises to furnish a means for securing orderly marketing and, perhaps, for establishing better control over the acreage seeded. The organization of cooperative selling machinery in the central markets, as well as in the country markets, may reduce the costs of marketing to some extent. It appears certain, however, that the farmer, under the cooperative system, will become a more skillful producer, and he will have the benefit of reliable market information and skillful guidance in selling.

Marketing Fruits and Vegetables.—There are so many individual differences in this classification of farm crops as to characteristics of the products, methods and conditions of production, location of producing areas, demand, and methods of marketing that no specific commodity can be used as a typical illustration. There are, however, certain general characteristics and methods that are more or less common to all; consequently, we shall discuss the marketing of fruits and vegetables in general and use specific instances for illustration when desirable.²

Characteristics of the Demand for Fruits, Nuts, and Vegetables.—The importance of fruits, nuts, and vegetables in our national economy is indicated in Table 42. The demand for these commodities does not fluctuate so much as the figures in this table indicate. Since they are in terms of dollars, a considerable portion of the decline since 1929 is due

¹ A British writer estimated that more than 50 per cent of the wheat shipped to Great Britain from Canada is controlled by the Canadian Wheat Pool. The Australian pools handle about 50 per cent of the wheat going to Britain. Two foreign firms are said to control 60 to 70 per cent of the Argentina wheat sales to Britain. A. H. Hurst, *The Bread of Britain*.

² The general discussion given here should be supplemented by some of the excellent studies on the marketing of individual products, published by the U.S. Department of Agriculture, state colleges of agriculture, and individual students.

to the fall in prices. This class of farm crops furnished 15.3 per cent of the average total farm income for the period 1924-1930. The percentage for 1933 was, however, 19.4. Fruits, nuts, and vegetables did not feel the effects of the depression to so great an extent as did the grains, livestock, and cotton.

TABLE 42.—GROSS INCOME FROM FARM PRODUCTION OF FRUITS, NUTS AND VEGETABLES¹

Year	Gross Income
1924	\$1,624,000,000
1925	1,876,000,000
1926	1,787,000,000
1927	1,752,000,000
1928	1,672,000,000
1929	1,838,000,000
1930	1,510,000,000
1931	1,183,000,000
1932	934,000,000
1933	1,123,000,000
1934	
1935	

¹ U.S. Department of Agriculture, Yearbook 1935. Preliminary estimate for 1935 was \$1,225,000,000.

The demand for fruits and vegetables is large in volume and widespread in distribution. The consumption of these agricultural products in both the fresh and processed¹ forms is growing rapidly. The production of spinach, for instance, increased 600 per cent from 1918 to 1934. Changes in our method of living have banished the city vegetable gardens and fruit trees; the large vegetable cellars have become obsolete; while the rapid growth of cities and the great publicity given to the healthful properties of fresh fruits and green vegetables have increased the demand.

The consumer now wants his fruits and vegetables throughout the year. The consumer has been led to believe that spinach, head lettuce, oranges, prunes, tomatoes, and many other fruits and vegetables possess valuable health-giving minerals and vitamins. The high prices that have to be paid for some of these products during the winter months prevent many people from satisfying their wants with the fresh varieties. They then turn to the canned supplies. The demand is typically small-scale and quite elastic during the heavy producing seasons for those products that can be processed by the housewife. The demand for other products becomes inelastic after the market has been well supplied at the customary price. Additional supplies can be moved only at a considerable reduction in price.

¹ Fruits and vegetables are processed in many different ways. They may be packed, dried, pickled, preserved, or made into juices, jellies, vinegars, and other varieties of manufactured goods.

Different parts of the country may have different tastes and customs. One variety of apple, peach, or potato will find great favor in one section, while another variety will be the favorite in another city. Many of the fruits and vegetables compete with each other. Oranges, grapefruit, and tomatoes are competitors; head lettuce and spinach compete with each other. Buyers are particular about quality when there is a large supply of a given product. The demand for some fruits and vegetables is influenced by weather conditions. The sale of melons, especially watermelons, is greatest in hot, dry weather; cool, rainy weather greatly reduces the sale of both melons and lemons.

The major demand for fruits and vegetables is found in the large industrial centers of the country, as is indicated by the following data: New York unloaded 125,500 carloads of these products; Chicago, 64,410; Boston, 36,839; and Philadelphia, 34,121, during 1928. Detroit and Pittsburgh were fourth and fifth, respectively, in the number of carloads received. The demand for fruits and vegetables is indicated by the number of "unloads" of the various commodities in car lots at sixty-six leading markets in 1934.

TABLE 43.—THE NUMBER OF "UNLOADS" AT 66 MAJOR MARKETS¹

Commodity	Number of carloads	Commodity	Number of carloads
Apples.....	34,565	Onions.....	24,164
Cabbage.....	23,652	Oranges.....	71,056
Cantaloupes.	17,770	Peaches.....	14,683
Celery.....	16,637	Potatoes.....	132,544
Grapefruit...	18,479	Strawberries..	9,034
Grapes.....	27,196	Tomatoes....	23,889
Lemons.....	13,630	Watermelons.	19,891
Lettuce.....	37,486		

¹ Compiled from the U.S. Department of Agriculture, Yearbook 1935.

Characteristics of the Supply Factors.—Fruits and vegetables as a class are bulky, although the individual units are frequently quite small. They are by nature highly perishable. This characteristic feature dominates the entire marketing process. Specialized facilities for transportation, such as refrigerator and heated cars, fast trains, and cold-storage plants, have been developed to meet this difficulty. These products, in common with other agricultural products, come from the field and tree in many different sizes, shapes, colors, flavors, degrees of maturity, and other qualities. This condition makes grading highly desirable. Weather and soil conditions affect quality as well as quantity of production.

Fruits and vegetables are produced under both small- and fairly large-scale methods. The development of the refrigerator car made possible the marketing of the products of the South in the North. The cheap land and labor available in the South, together with favorable climatic conditions, made possible lower costs of production with the result that there was a great development of the industry in the South and the West.

Sources of Supply.—California, for the year 1928, shipped 184,225 carloads; 41.9 per cent was transported more than 3,000 miles to market, and 35 per cent was carried by rail between 2,000 and 3,000 miles.¹ Florida produced 57,895 carloads, and about 85 per cent traveled between 1,000 and 2,000 miles. New York and Chicago secured their supplies of fresh fruits and vegetables from no less than 43 states. The smaller cities, such as Akron, Youngstown, and Terre Haute, received their fruit supply from as many as 38 states. While practically every state shipped some fruit or vegetable to one or more of the 66 largest markets, 71 per cent of the total number of cars unloaded in these terminal markets came from 9 states.² California, Washington, and Arizona shipped to all of the major consuming centers.

It should be kept in mind that these figures on car loadings do not include the large amount of produce that reached the markets by trucks. It is estimated that 90 per cent of the market crop of potatoes in Pennsylvania moves by automobile or truck (1930–1931); 57 per cent of the western New York crop was transported by truck in 1928. Thirty-six per cent of the potatoes produced in the thirty-five late-potato states were shipped in carload lots during the five-year period ending with the 1926 season. Of the 1926 potato crop, 35.5 per cent was shipped in carload lots and 28.7 per cent by motor truck and l.c.l. lots. It was estimated that almost 16 per cent was used as food on the farm, slightly more than 9 per cent was used for seed, and the remainder was unfit for food or seed. Potatoes are grown in considerable quantities in every state in the Union. About 37 per cent of the farms in the country produced potatoes in 1925. The preliminary estimate of the probable planting for 1934 was 3,303,000 acres with a probable final harvest of 385,287,000 bushels.

The major sources of supply for some selected commodities are given to illustrate the diversity of geographical area involved. Georgia and Florida, for example, produce half of the national watermelon supply. Texas, Florida, and California produce more than half of the commercial tomato crop that reaches the markets in carload lots. Maryland ranks

¹ The relative positions have not changed materially since 1928.

² These states were California, Florida, New York, Washington, Virginia, Maine, Georgia, Texas, and Idaho. *Chicago Sunday Tribune*, Oct. 5, 1929.

first in the production of canning tomatoes. More than 514,000 acres were planted in tomatoes in 1934. The strawberry supply comes on the market in four periods, *viz.*, the early, second early, intermediate, and late crops. The supply moves northward with the season from Alabama, Florida, Louisiana, and other southern states to Michigan, New York, Wisconsin, and other northern states. Approximately 197,660 acres were cultivated in 1934. Texas and Virginia are the leading spinach-producing states.

The season for the shipment of celery starts in October in northern California. The shipments reach the peak in December for this part of the state. The shipping starts in January and reaches its peak in March in southern California. Florida begins shipping in December and reaches its peak in April. Michigan celery comes to the market during the summer months. New York ships its major supply from August to December. These four states grew four-fifths of all celery produced in 1934. Shipments from various states usually overlap. Some of this overlapping is due to weather conditions. The money received by the growers for the 1934 celery crop was approximately \$10,500,000; for 1931 the returns amounted to \$17,000,000.

Wisconsin is the leading state in the production of peas for canning purposes. This state furnished approximately 43 per cent of the commercial supply in 1934. All the planting in the United States totaled 250,370 acres for the year. Texas, Michigan, and Indiana are the leading onion-producing states; California and Arizona lead in the production of lettuce; California, Arizona, and Colorado are the chief cantaloupe-producing states; California and Texas are the leading sources of supply for carrots; New York, Texas, and Wisconsin produce two-thirds of the cabbage crop that moves in carload lots; Washington and New York produce more than half the commercial apple crop. California, Georgia, and North Carolina are the leading states in the production of peaches. California alone, however, furnishes more than half the commercial crop. The total production for the entire country equaled approximately 45,404,000 bushels in 1934. California produces approximately 90 per cent of the commercial grape supplies of the country. Since the major consuming centers are in the northeastern quarter of the country, the necessity for a rapid and efficient marketing system is obvious. The risks arising from the possibility of loss from spoilage and glutted markets are clearly evident.

Some Problems of Production.—The producer of fruits and vegetables is confronted with many hazards from the time of preparing the soil to the end of the marketing period. These dangers arise from the possibilities of over-production and from damage to the crop by frost, drought, rain, hail, storms, insects, and disease. The demand may be unex-

pectedly curtailed owing to unemployment in the large industrial centers.

The orchard crops cannot readily be adjusted to rapid changes in demand. Vegetable production, on the other hand, is, generally speaking, subject to much greater flexibility. The Florida celery growers, for example, decided in 1932-1933 to control the production and shipment of their crop. They destroyed 750 acres of celery because it did not pay to gather, crate, and ship it to market. They agreed, in 1934, to limit shipments to the market demand. At one time it was highly profitable for a farmer to plant his orchard in many varieties of the same kind of fruit so as to be able to produce and market for the maximum number of weeks during the season. This practice is no longer advisable owing to the development of the refrigerator car, express service, and highly developed geographical specialization. The farmer following the old plan finds his early varieties in competition with products shipped from far-distant points in the South; his late varieties meet competition from farm products shipped from far-distant points to the North. His best plan is to specialize in a few varieties that best fit in with his climate, soil, and market. The consumer demand for fruits and vegetables over a long season is met most satisfactorily by extending the area from which the produce is shipped rather than by the production of many varieties in a restricted area. Each group, however, is produced under rather intensive methods of cultivation.

The producer of orchard crops has to take a long-run view. It takes an apple orchard from five to eight years to get to the point where it will pay expenses and two to five years more to reach full production. Peach and plum orchards require about three years to reach the profitable stage. This situation often makes long-term financing necessary. The owners of orchards have the cooperative spirit highly developed. They typically own their homes and frequently handle the harvesting, grading, packing, and selling activities through their cooperative associations. Vegetables, on the other hand, are quite frequently produced by tenants; the cooperative spirit is not so highly developed among this class of producers. The seasonal character of production promotes a less stable situation than is found in the fruit industry.

Methods of Marketing Fruits and Vegetables.—Fruits and vegetables are sold *directly* from producer to the consumer and to the processing plant; *indirectly* through several different kinds of middlemen and through cooperative associations. Cooperatives are especially effective in marketing apples, oranges, lemons, grapefruit, grapes, raisins, and plums.

The farmer sells a large quantity of fruits and vegetables indirectly because he finds it more convenient than to attempt to do his own selling.

processing, grading, and repacking or to grant credit, make collections, and assume risks from shrinkage and spoilage. The consumer buys from the local retailer because of convenience. He gets the quality, variety, and quantity he wants at the time, place, and on the terms of sale desired. The typical producer obviously cannot give these services. The fruits and vegetables consumed throughout the year must come from different parts of the country as the seasons change. The middlemen are needed to provide the services necessary for concentration and dispersion.

The Control of Production and Shipments.—The growers of a number of fruits and vegetables, through their cooperative associations and under the leadership of the A.A.A., developed rather effective methods of control over production and shipments. This practice resulted in substantial increases in returns to the growers. The Bartlett pear interests of California, for example, formed a committee comprising growers and shippers, which decides how many carloads of pears shall, in the interests of all concerned, be shipped at any given time. It is the function of this committee to keep informed on market conditions and supplies and then to release shipments as the market can absorb them. The former irregular daily shipments have been smoothed out to a considerable extent. More pears were shipped during 1934 than in 1933 in about the same length of time, but without the extreme day-to-day fluctuations. On three days during the season no shipments were made. The committee released a certain number of cars each day, the number depending on market conditions. This plan is known as the "period-to-period proration" method. It has been used for other fresh tree fruits except apples from California. The growers of California Tokay grapes, Florida celery, California fresh asparagus, vegetables from western Washington, and California and Arizona oranges and grapefruit use a similar plan. The same general plan with some additional features is used by the growers of fresh tree fruits in the Northwest, Colorado peaches, Texas and Florida citrus fruits, California Gravenstein apples, and Southeastern potatoes.

The Southern Watermelon Growers' agreement provides that a committee of growers and shippers can declare shipping holidays of not more than 48 hours and not more frequently than every five days. These plans do not necessarily limit supplies; they may merely regulate the flow. Sometimes agreements to limit the supplies are formed. The California cling-stone peach canners agreed, for example, to limit the pack to 10,000,000 cases. This meant that 45,000 tons of peaches had to be left on the trees. The growers received \$15 a ton for those left on the trees, and \$20 a ton for those used. They received \$5,500,000 for the 1933 crop in contrast to the less than \$1,000,000 realized on the 1932

output. The receipts for the 1934 crop were approximately \$6,000,000. The 1934 California canning asparagus crop was also marketed under this form of agreement.

Another form of agreement used by some growers provides that only top-quality fruit be permitted to go to market first, with lower grades held for use as by-products. The agreement of the California prune growers is an illustration. The committee fixes the price to be paid for top-grade prunes and limits the number of tons that can be moved. Other agreements that provide for the control of quality, grades, and sizes are used by the growers of Florida and Texas citrus fruits, Florida strawberries, Southwestern watermelons, and California cling-stone peaches. Some agreements establish minimum prices; six of the agreements contain this provision.

Are the Control Plans Socially Desirable?—Are such agreements as those listed above socially desirable? As in most questions, there are two sides. According to estimates, as much as 30 per cent of the Florida grapefruit shipped to New York in one season sold for less than it cost farmers to put the fruit on the market. The celery producers and the peach and potato growers, to cite only a few cases, sometimes find the prices so low that they do not justify the harvesting of a considerable portion of the crops. Such conditions are undesirable. There may be a valid objection, on the other hand, to the practice of fixing the price or of permitting only the top grade to go to market. These practices may raise prices so high that many people on low incomes in the cities will be forced to forego the use of the commodities. If the lower grades were allowed to reach the market, this class of consumers would be able to supply its needs. The control of shipments so as to regulate the rate of flow to market, thereby preventing gluts but not reducing the total supply, is praiseworthy. Such practice will benefit the producer without penalizing the consumer. While agreements may succeed in regulating production and the rate of flow to the markets, they cannot change weather conditions and the characteristic features of the various products, which will still retain their perishable feature; and we shall continue to have cold and hot days, and dry and wet weather.

Services and the Agencies That Perform Them.—The characteristics of the demand, the product, and the methods of production of fruits and vegetables make necessary the performance of a number of services by specialized agencies.

The farmers may sell their fruits and vegetables to the housewife, to the local grocery and fruit store, and to the local canning factory. They may sell through a cooperative association, to a buyer sent out by some terminal wholesaler, or to a local shipper who assembles the product,

perhaps grades,¹ packs, stores, and then ships it to some central market where it is being concentrated for economical dispersion. Some farmers sell their vegetables on contract to a factory before the seeds are planted; fruit may be sold on the tree, the buyer picking, grading, and packing it in the orchard and then transporting the product to the shipping point.

Terms of Sale.—There are numerous bases of sale upon which these products may change hands. If the product can be sold on a dependable grade, sales may be made by wire on a delivered basis, or "f.o.b. usual terms." That is, the price is agreed upon before shipment but the buyer pays transportation costs, and acceptance is subject to inspection for grade at destination. Sales may be made for cash after the car is loaded. The buyer accepts title then and there without the privilege of rejection when the car reaches the terminal market. Some sales are made on a contract for future delivery; the usual practice is to pay cash upon delivery. The local shippers and producers may ship their goods on consignment to commission men in the terminal market. The shipper, obviously, retains all the risks incident to ownership until his agent has succeeded in selling the product. Sales may be made in transit when supplies are heavy and the demand in the various central markets is uncertain. Diversion privileges allow the shipper to reach the most favorable market and thus prevent congestion and gluts.

Functionaries of the Central Markets.—There are sixty-six large central markets for fruits and vegetables in the United States. The major functions performed by the middlemen in these markets are to concentrate, store, grade, repack, and distribute the produce among jobbers and retailers and to smaller distributing centers in the adjacent territory. The central markets are located in the densely populated industrial centers where a large volume of sales is possible. In addition to the commission houses and brokers² who perform the usual functions of such agents, there are so-called car-lot wholesale receivers and jobbers. The car-lot receivers buy in carload lots and sell in l.c.l. lots to jobbers, large-scale retailers, and wagon jobbers. The wholesaler receives, for example, a carload of lettuce containing 320 crates; he sells to a jobber who, ordinarily, buys in 20-crate lots, or about one-sixteenth of a carload. This functionary then sells to a retailer who typically buys only one

¹ The U.S. grades for celery, for example, are U.S. fancy, U.S. No. 1, and U.S. No. 2. The qualities considered in grading are whiteness, cleanliness, freshness, length, absence of plant disease and blemishes.

² The commission houses furnish a satisfactory outlet for low-grade merchandise that cannot be sold directly to the wholesale trade. Since they deal in l.c.l. lots, they furnish an outlet for those who do not ship in large quantities. The brokers usually sell in car lots to the wholesale trade. They act as representatives and salesmen for growers and local shippers of car lots. It is commonly believed that the activity of produce commission men tends to increase sales.

crate, or $\frac{1}{320}$ of a carload at a time. The consumer buys from the retailer in small amounts, usually one head of lettuce, or $\frac{1}{7,680}$ part of a carload.¹

The auction company is an important factor in aiding in the dispersion of perishables for cooperative associations, wholesale receivers, brokers, and commission men. The jobber may buy in both large and small quantities but he sells to small-scale retailers; one of his functions is to break bulk.² The terminal market shipper is a merchant located in the central market who assembles a variety of fruits and vegetables in carload lots to meet the needs of dealers in smaller near-by towns. He may buy and sell produce in carload lots when the needs of the smaller markets so require. With the rapid growth of some of the cooperative associations³ there has appeared in some of the markets a new functionary—the representative of the cooperative. This agent may perform the functions of a broker or act more as a “watcher” to report market conditions to his principal.

The entire market organization for fruits and vegetables is constructed for the purpose of securing rapid handling. This is necessary because of the perishable character of the product. Great loss may result from delay in transportation, inadequate terminal facilities, and improper loading, packing, warehousing, and storage.

Cost of Marketing Fruits and Vegetables.—The amount of reliable information on costs of marketing fruits and vegetables is very limited. The following data are cited for illustrative purposes. The distance from the market, the degree of perishability, the methods of marketing used, the need for storage, and the amount of taxes and license fees bring about considerable variation in costs of marketing the same kinds of commodities.

The California Fruit Growers' Exchange⁴ estimates the cost of marketing California oranges at approximately 50 per cent of the retail price. If we assume that the consumer spends \$1 for oranges, the

¹ From a study by the New York Port Authority on the marketing of produce.

² The position of the fruit and vegetable jobber seems to have been adversely affected by the growth of chain stores. The chains are getting more and more of the retail produce business; consequently, as the independent retailers drop out, the jobber loses business. The chain stores buy in carload lots and so do not typically deal with the jobber. The auctions compete with the jobber for the pushcart and fruit-store business; some of the commission men do a jobbing business with some of the near-by independent retailers, while truck drivers are taking some of the jobber's business in outlying towns.

SHERMAN, *Merchandising Fruits and Vegetables*, Chap. XXVI.

³ Cf. California Fruit Growers' Exchange, Federated Fruit and Vegetable Growers, Florida Citrus Exchange, American Cranberry Exchange, the Skookum Packers' Association.

⁴ Bull. for 1931.

retailer receives as his margin 27.2 cents, the jobber 6.4 cents, and transportation functionaries 15.1 cents. Selling and advertising amount to 1.5 cents, while picking, hauling, and packing cost 9 cents. After these expenses have been met there remains 40.8 cents for the grower. The retailer gets 21 cents of the dollar spent by the consumer for potatoes, the jobber 5 cents, the wholesale receiver 5 cents, the railroad 17 cents, the country dealer 4 cents, and the grower 48 cents. The dollar spent for head lettuce by the housewife is divided as follows: the retailer receives 41 cents, the country buyer gets 8 cents, freight and refrigeration expenses amount to 23 cents, and crates and packing cost 10 cents. This leaves 18 cents for the grower.¹ The long distance traveled in reaching the market and the high degree of perishability of the product are the chief reasons why the growers, on the average, receive such a small percentage of the retail price.

Table 44 gives the costs of marketing Pennsylvania potatoes, under the indicated conditions, as reported by the State College.

TABLE 44.—MARKETING COSTS TO FARMERS BY METHOD OF MARKETING FOR POTATOES HAULED BY TRUCK OR AUTOMOBILE, 1928 CROP¹

Method	Marketing cost per bushel						Price per bushel ² received by grower
	Grading, cents	Loading, cents	Trip expense			Total, cents	
			Labor, cents	Truck, cents	Total, cents		
Sold at farm:							
Trucker.....	2.0	0.4	...	....	....	2.4	56
Consumer.....	2.4	0.4	...	....	....	2.8	83
Hauled by grower to market:							
Local retail store.....	3.3	0.4	2.6	8.3	10.9	14.6	79
House delivery.....	2.3	0.4	4.8	7.9	12.7	15.4	75
Market house.....	2.7	0.4	2.4	13.3	15.7	18.8	65
Curb market.....	2.4	0.3	1.7	16.2	17.9	20.6	71
Chain store.....	2.4	0.5	1.7	5.4	7.1	10.0	60
Hotel or restaurant.....	1.9	0.4	2.9	4.9	7.8	10.1	71
Commission ³	2.6	0.1	7.4	2.4	9.8	12.5	65
Avg.....	2.4	0.4	1.8	3.9	5.7	8.5	66

¹ Pennsylvania State College Bull. 278, p. 29, 1932.

² *Ibid.*, p. 27.

³ For commission sales, the labor cost of trip expense includes a flat charge of 10 or 11 cents per bushel for trucking part of the potatoes from the farms to the commission house, 30 miles away.

The costs of grading are small; the costs of loading are much less, although the variation is great, *e.g.*, from one-half of 1 cent per bushel when sold to chain stores to only one-tenth of 1 cent when sold to com-

¹ U.S. Department of Agriculture, Bull. 1412, p. 33.

mission agents. The truck expense mounts greatly when the farmer sells at the market house or on the curb market. This is due, of course, largely to the idle time. The price varies with the buyer. Thus the farmer charges the consumer 83 cents a bushel but lets the trucker have the product for 56 cents. He gets 79 cents from the local retail store but only 60 cents from the chain store. The expenses involved in selling to the latter, however, are almost a third less than when selling to the former.

The *Louisville Survey* found that the gross margin of the retailer who sold fresh vegetables was 35.3 per cent, while his operating expense for selling this item was 16.2 per cent, which left a net profit of 19.1 per cent. The gross margin on fresh vegetables was 35.5 per cent; the operating expense was 17.2 per cent, which left a net profit of 18.3 per cent.¹

Consumers and producers, in their criticism of the prices of fruits and vegetables, are likely to overlook the risks and services involved in marketing such perishable commodities. Why costs of marketing fruits and vegetables consume such a large portion of the amount paid by the housewife is suggested in the following quotation from Dr. Weld.

For example, consider the marketing of California cantaloupes in Philadelphia. This was not done 40 years ago. Today, the grower gets only about 15 per cent of the retail price. He gets 2 or 3 cents, and the consumer pays 15 cents. Does this mean that the marketing is inefficient or that any crime has been committed against society by marketing this product? After harvesting, cantaloupes have to be graded and packed. They are hauled to and loaded into a refrigerator car that has been iced for 24 hours. The car travels 3,000 miles, and has to be re-iced several times en route. On arrival in Philadelphia, the product must be cleared through wholesale channels and delivered crate by crate to individual retailers, all in a few hours, because new shipments will arrive the next day. In the retail store, the consumer picks out the best cantaloupes. Many have to be sold at a sacrifice, or thrown away. The wonder is that it is possible for these perishable products to be marketed at all, so as to yield prices to growers that cover production costs and so that they can be sold in Philadelphia at prices that consumers can afford to pay.²

The Major Problem.—The major problem met in the marketing of fruits and vegetables is connected with the control of production and of the rate of flow to market. Production from day to day, *e.g.*, the rapidity with which fruit and vegetables may ripen, is influenced greatly by weather conditions. Certain markets may receive a large portion of the shipment for a few days in succession. A combination of these factors frequently gluts the market, prices fall to the bottom, and the product cannot be sold in quantity for any price. There is a large fluctuation in

¹ U.S. Department of Commerce, *The Louisville Survey*.

² WELD, L. D. H., *The American Marketing Journal*, p. 82, April, 1934.

prices from year to year, month to month, week to week, and day to day and for different lots on the same day. Ranges in price of 50 per cent in one day are not unknown. The demand over a short period is fairly inelastic and is affected by weather conditions. Prices at any particular place and time are influenced by custom, prices for the previous day, and the volume of goods on hand and on the way.¹

It has been found that, whenever a potato crop of the United States has approached or exceeded 3.8 bushels per capita, the price has tended downward during the season, but the price trend has usually been upward whenever the yield fell below 3.2 bushels per capita. A crop of 422,000,000 bushels in 1924 sold for only \$264,000,000, while a crop of 323,000,000 bushels in 1925 sold for \$602,000,000. A cabbage crop 20 per cent below normal raised farm prices 82 per cent, while a crop 20 per cent above normal reduced prices 39 per cent. These figures clearly indicate the effect of over-production upon prices. The problem confronting the producer is in part a task of controlling the *yearly supply* and the *daily rate of flow* to the markets. This control is dependent upon adequate information and concerted action among producers.

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¹ The fluctuations in the price of peaches, for instance, have been found to be due to differences in supply, variety, size, condition, grade, and the pack. "By centering production on the most desirable varieties and by restricting shipments to the larger peaches in first-class condition, properly packed, growers can do much to help maintain prices and returns in years of large crops and depressed prices." Cf. "Factors Affecting the Price of Peaches in the New York City Market," *U.S. Department of Agriculture, Technical Bull.* 115.

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Questions for Discussion

1. What are the major remote and immediate sources of the agricultural marketing problems? Consider the possible sources under the following headings: social, economic, and political.
2. "The products of agriculture usually come into the local market in relatively small lots of ungraded, unstandardized raw material for which the producer assumes no responsibility." How does this condition affect the marketing problem? What services are required to complete the marketing process?
3. "The principal outlet for farm products after they leave their country shipping points is the city wholesale markets." What are the main purposes of these markets? What are their functions?
4. Do you believe that the forces of supply and demand, as they apply in the field of agricultural marketing, can be effectively controlled over a long-time period through political action? Justify your answer.
5. Is any given country justified in maintaining a price for a commodity or a group of commodities on a materially higher level than the world price level? For example, the price of wheat in some European countries has been \$1.80 to \$2.60 a bushel when the Liverpool price was less than 80 cents. The price in the United States has been 20 cents above the Liverpool price when normally it would be 15 to 20 cents below the Liverpool price. During 1934 Germany is reported to have maintained a tariff of \$3.85 a bushel, and Italy a tariff of \$1.75 a bushel on wheat.
6. Do such conditions as mentioned in question 3 "tax" the consumer for the benefit of a privileged class, i.e., the farmer? Justify your answer.
7. Suppose your answer to question 4 is "yes." Are such results socially and economically desirable? Are they politically desirable or expedient? Justify your answers.
8. "The supply and demand for wheat have become unbalanced." Why? How can they be brought into balance? Does the objective or end desired justify the use of any means or method? Justify your answer.
9. Explain how, using the grains as an illustration, the personality of the producer, the characteristic features of the demand, the product, and the conditions of production, influence the method of marketing.

10. Do you believe that the costs of marketing wheat can be substantially lowered by the farmers, through their cooperative associations performing all the marketing functions between the individual producer, on one side, and the miller and exporter, on the other? Would the situation be improved if the farmers added the manufacturing process to their activities? Suppose the consumers on the other end organized cooperatively and established retail and wholesale stores, would costs be reduced with the net results that the consumer could buy at lower prices and the growers sell at higher prices? Justify your answer by citing reliable information.

11. Are transportation costs for the shipment of wheat, fruits, and vegetables relatively high? What is the basis of your opinion?

12. The "control" plans developed by the growers and shippers of some of the major fruit and vegetable crops have been quite effective in increasing the returns to the farmers. Has this been at the "expense" of the consumer? Has the increase been secured by "taking it out of the profits of the middlemen"? Justify your answer.

13. "The processing tax puts American people on relief and the dole and furnishes jobs to people from foreign countries to grow necessary articles for us." Do you agree?

14. Indicate by diagrams the "channels" through which each of the following products passes on its way to the ultimate consumer: wheat, corn, celery, oranges, apples, and strawberries.

Assignment

1. Problem 2, p. 318. Perfex Mills—Purchasing Wheat.
2. Problem 1, p. 107. Chicago Produce Market.

CHAPTER X

MARKETING AGRICULTURAL PRODUCTS—FARM CROPS AND LIVE STOCK

Purpose of this chapter: To survey the problems encountered in the marketing of farm crops and live stock; to examine the methods of marketing used in the type cases, i.e., cotton, coffee, and hogs.

Marketing Fibers.—The third major group of farm crops comprises the fibers. The four commodities cotton, jute, hemp, and flax are the most representative of the class. Since cotton is by far the most important member of the group, we shall use it as a case.

Marketing Cotton.—The importance of cotton in our social, economic, and political life is indicated by the number of growers, the acreage planted, and the annual gross income received by the farmers. Approximately 1,000,000 cotton farmers signed cotton-acreage reduction contracts in 1934; there are probably more than 2,000,000 growers producing cotton in the United States. The annual plantings normally average approximately 41,000,000 acres; the estimated number of acres seeded in 1934 was 28,000,000. The gross income received by the farmers for their cotton and cotton seed for the years indicated is given in Table 45. The cotton farmers received 12.3 per cent of the average total annual farm income for the period 1924–1930. The percentage for 1933 declined to 11.1.

The Demand for Cotton.—The demand for cotton is large-scale, world wide in scope, inelastic for specific grades, continuous, and quite stable.

TABLE 45.—GROSS INCOME OF COTTON FARMERS¹
(Cotton and seed)

Year	Gross Income
1924	\$1,710,000,000
1926	1,251,000,000
1928	1,470,000,000
1929	1,389,000,000
1930	751,000,000
1931	528,000,000
1932	464,348,000
1933	684,186,000†
1934*	

¹ U.S. Department of Agriculture, Yearbook 1935, p. 672.

* The estimated farm value of cotton as of Dec. 1, 1934, was \$612,802,000. This figure, however, is not comparable with the other figures given in the table. The gross farm value of the 1933–1934 crop including benefit payments was almost \$880,097,000. *Ibid.*, p. 39.

† The cotton farmers received, in addition, for the 1933 crop \$112,000,000 benefit payments and more than \$50,000,000 profits on options. The payments for 1934 were approximately \$117,000,000.

Cotton is used chiefly as a raw material by industry in the production of many varieties of manufactured goods. The material is typically bought in large quantities for mass production. The demand for the fiber depends on the demand for the manufactured products.

The demand for cotton and cotton goods is world wide. Practically all civilized countries have manufacturing concerns that utilize cotton as a raw material. These countries and many so-called backward countries are consumers of cotton goods. This product is used on a large scale as raw material for the manufacture of a wide variety of goods. The United States Census of 1919 shows that 50 per cent of the cotton went into clothing, 16 per cent into household furnishings, and 34 per cent into products to meet the needs of industry.¹ The United States, the United Kingdom, and Continental Europe consume approximately 70 per cent of the world's production. Japan and Russia are becoming more important as buyers of cotton. The United States used about 26 per cent of the world's production of cotton annually before the World War and has been consuming about 29 per cent since. The spinner, in fact, is the ultimate consumer of raw cotton. New England and the southeastern part of the country contain the more important spinning centers in the United States.

The demand for cotton is quite inelastic. The volume of consumption remains fairly even under normal conditions. If there is a great shortage, prices advance sharply; and if there is a great over-supply, prices fall drastically before consumption is increased. The experiences of the cotton industry during 1930-1935 give ample support to the statement.

The demand is affected to a considerable extent by the type and quality of the product. Since cotton is used to produce such a wide variety of manufactured goods, it is natural to expect a demand for various specific kinds and grades of fiber. The northern mills in the United States require much high-grade cotton, such as American Egyptian, the long-staple upland cottons, and sea-island cotton.

The demand for cotton is continuous throughout the year. The volume of consumption is affected to some extent by business conditions. When consumers are out of work, they do not buy clothing and household furnishings freely; when industries are not making sales, they do not need the cotton products they normally buy. Much thought has recently been given to ways and means of increasing the consumption of cotton by developing new uses. There is a considerable demand for products that can be made from the cottonseed, such as oil. The linters that stick to the seed after the cotton is ginned have become valuable because of their use in making paper, celluloid, rayon, artificial

¹ The cotton was manufactured into such products as tire duck, bags and bagging, twine, rope, cordage, yarns, and drill.

leather, and stuffing for mattresses. The consumer demand for cotton goods has declined with the recent changes in fashion and the great popularity of rayon.

The Amount Demanded.—The size of the demand for cotton is reflected by figures showing mill consumption. Table 46 gives the United States consumption of home-grown and imported cottons, foreign consumption of American-grown and of all other growths, and the total world consumption of all growths. The average annual world consumption of all growths for the eight-year period 1925–1926 to 1932–1933 was 24,504,000 bales. The average annual consumption in the United States was 6,243,000 bales.¹ During this period the average annual consumption of American-grown cotton by foreign countries was 7,950,000 bales. Foreign manufacturers, therefore, accounted for slightly more than

TABLE 46.—DEMAND FOR COTTON¹
(Mill consumption)

Year beginning Aug. 1	U.S. con- sumption of home grown and imports, 1,000 bales	Foreign consumption of		Total world consumption of all growths, 1,000 bales
		American grown, ² 1,000 bales	All other growths, ² 1,000 bales	
1925–1926	6,456	7,834	9,640	23,930
1926–1927	7,190	8,868	9,811	25,869
1927–1928	6,834	9,041	9,410	25,285
1928–1929	7,091	8,448	10,243	25,782
1929–1930	6,106	7,218	11,554	24,878
1930–1931	5,263	6,029	11,110	22,402
1931–1932	4,866	7,762	10,268	22,896
1932–1933	6,137	8,401	10,448	24,986
1933–1934	5,700	8,127	11,497	25,324
1925–1926 to 1932–1933 average.....	6,243	7,950	10,311	24,504

¹ U.S. Department of Agriculture, Yearbook 1935, p. 432.

² American in running bales, and other growths in bales of 478 lbs.

56 per cent of the total consumption of American-grown cotton. The world consumption of cotton for the year ending January 31, 1935, was 24,725,000 bales.² This was about 280,000 bales more than the eight-year average cited above. The world consumption of American-grown cotton, however, was only 11,964,000 bales compared with the eight-year average of 14,193,000 bales. The United States consumed 5,320,000

¹ The average annual per capita consumption in the United States for the period 1920–1933 was approximately 23 pounds; for 1930–1933 it was 20 pounds; and for 1925–1929 it was 26 pounds. *Regional Problems, op. cit.*, p. 8.

² *New York Journal of Commerce*, Apr. 1, 1935.

bales of domestic-grown cotton during the year. Japan consumed 3,545,000 bales in the same period; 1,728,000 bales of this amount was American-grown cotton. India and China, the second and third largest consumers of cotton in 1934, bought very little American-grown cotton. Great Britain, however, was second only to Japan in the amount of American-grown cotton consumed. This country used 2,449,000 bales in the year ending January 31, 1935; approximately half of this amount came from the United States. Russia, France, Italy, Germany, and Brazil are large consumers of cotton. Russia and Brazil, however, use very little cotton grown in the United States. It is interesting to note that the three Asiatic countries Japan, China, and India consumed 8,790,000 bales, or slightly more than 35 per cent of the world consumption, for 1934. These countries had less than 15½ per cent of the world's cotton spindles. These figures indicate that the spindles are used many more hours a day in the Orient than in the United States and Western Europe. The world consumption of cotton increased 3 per cent during 1933 over the preceding year, but there was a decline of 4 per cent in the United States consumption.¹

Characteristics of the Supply Factors.—The United States produces, normally, more than half the world cotton fiber supply. The International Institute of Agriculture listed seventy-six countries in 1926 as producers of cotton. Many of them, however, produce insignificant quantities. The position which the United States holds in the world production of cotton is indicated in Table 47. The loss of first place in production, by the United States, is evident. This is probably a temporary situation caused by the droughts and the policies of the A.A.A.

TABLE 47.—WORLD COTTON PRODUCTION
(In thousand 500-pound bales)

Region	1931-1932	1932-1933	1933-1934	1934-1935*
United States.....	16,877	12,961	12,715	9,145
Foreign.....	9,858	10,624	12,646	13,225
Total.....	26,535	23,585	25,361	22,367
Per cent U.S.....	63.6	55.0	50.1	40.9

* The consumption of cotton by foreign mills for the first ten months of 1935 was 16,743,000 bales; only 5,093,000 bales of the total were American cotton. For the first ten months of 1933 more than 7,000,000 bales of American cotton were consumed. D. C. Harrower, *Barron's Weekly*, p. 12, Aug. 12, 1935.

The figures for the United States cited in this table do not agree exactly with those given in Table 48. This is due to the fact that they are taken from different sources. The small variation, however, is not material, as it is the relationship we are interested in at this time.

¹ *Ibid.*

Foreign countries produced in 1933 more cotton than the United States for the first time since the Civil War. Production in the United States declined 25 per cent during 1933-1934, while the production outside the United States increased 20 per cent. Brazil expanded its production very materially, while the United States was curtailing production.¹ The world production for 1933-1934 was estimated at 25,361,000 bales; for 1934-1935, at approximately 22,367,000 bales. The world production outside the United States for 1934 was probably between 13,000,000 and 14,000,000 bales. The more important foreign cotton growing countries are Russia, Brazil, Egypt, India, and China.

Since Egypt, India, and China must take precautions to maintain their food supply, there is a limit to the amount of acreage they can devote to cotton. Some students of cotton argue that these countries have reached their limit. It is believed that Russia can use any increase in its own production possible to attain within the next several years. Manchuria, Asia Minor, Mexico, Peru, Africa, and Australia have expanded production in recent years, yet the effect upon world supplies is not likely, according to these estimates, to be disturbing. Brazil, on the other hand, has great potential resources for increasing her cotton production. When cotton raising becomes more profitable than coffee production, cotton acreage expands readily. The production of Brazilian cotton, in recent years, has increased from 400,000 bales to 1,250,000 bales. The land area suited for cotton production in Brazil is greater than that in the United States. Labor and capital are the limiting factors when world prices are favorable.²

The American Supply.—The important position held by the United States as a source of supply for cotton is indicated by Table 48. The annual average production for the eight-year period 1925-1926 to 1932-1933 was 14,825,000 bales. Three seasons during this period exceeded 16,100,000 bales; one of these seasons, 1926-1927, reached the high figure of 17,755,000 bales. This was followed the next season by the abnormally low yield of only 12,783,000 bales. The steady accumulation of supplies is indicated in the two columns headed Total carryover and Total supply. The total carryover from the previous season increased very rapidly after 1929-1930 until a peak of approximately 11,750,000 bales was reached in 1933-1934. The annual average carryover for the eight-year period was 4,293,000 bales. The total American supply, which includes the year's production, the carryover from the previous season, and imports, reflects the same general situation. The total supply reached the high figure of 23,131,000 bales in the 1932-1933 season. The eight-year annual average was 19,402,000 bales.

¹ The Brazil production for 1935 was estimated at approximately 1,700,000 bales.

² National City Bank, *News Letter*, October, 1934.

TABLE 48.—COTTON SUPPLY—UNITED STATES¹

Year beginning Aug. 1	Production (running bales), 1,000 bales	Im- ports, 1,000 bales	Total carry- over from previous season, 1,000 bales	Total supply, 1,000 bales	Weighted average price, cents per pound ²
1925-1926	16,123	326	1,610	18,059	19.6
1926-1927	17,755	410	3,543	21,699	12.5
1927-1928	12,783	338	3,762	16,883	20.2
1928-1929	14,297	458	2,536	17,291	18.0
1929-1930	14,548	378	2,312	17,238	16.8
1930-1931	13,756	108	4,530	18,394	9.5
1931-1932	16,629	132	6,370	23,131	5.7
1932-1933	12,710	130	9,678	22,518	6.5
1933-1934	12,664	148	8,165	20,977	9.7
1934	9,474	...	.....	20,360	12.4
1935	11,464	...	.....	20,805	
1925-1926-1932-1933 average.....	14,285	285	4,293	19,402	13.6

¹ Compiled from *U.S. Department of Agriculture, Yearbook 1935*, p. 430 except for 1934 and 1935. The production for 1934 was estimated at 9,636,000 bales, and for 1935 at 11,464,000 bales. The total supply including carryover was 20,360,000 bales in the former year and 20,805,000 bales the latter year.

² Average price received by American producers.

The United States imports only a small amount of cotton, and this is of a distinctive quality which is used for special products.

The effects of the constantly increasing supplies on the prices received by the American growers are clearly indicated in the last column of Table 48. The farmers received 19.6 cents a pound, on the average, in 1925-1926 but only 12.5 cents in 1926-1927 owing to the enormous supply of almost 21,700,000 bales. The following year, however, the price climbed to 20.2 cents in response to the small production that year. Following this season the price declined steadily to the low established in 1932. The average price received by the farmers for the 1931-1932 season was 5.7 cents.¹

The supply of cotton, as was suggested above, may vary widely from year to year. This is due to the hazards coming from weather, insects, and disease and to the practice of the growers of increasing their plantings following a season of relatively high prices. The average yield in 1933 was 208.5 pounds per acre, while the yield the following year was only 162.6 pounds, a decrease of 45.9 pounds per acre, or more than 22 per cent. This decline reflected the blighting effects of the drought. The foregoing figures are averages for the United States.

¹ The low point of 4.6 cents a pound was reached in June, 1932. The price on Aug. 26, 1935, was 10.85 cents; one year earlier it was 13.35 cents a pound.

Individual sections of the country show much wider variations in output. The average yield in Oklahoma, for example, declined from 208 pounds per acre to 80 pounds, or a decrease of 128 pounds. Some of the eastern cotton states, on the other hand, showed an increased yield, yet Georgia suffered a decrease of 36 pounds per acre. Over a period of several years the production of cotton in the United States has tended to shift westward and northward owing to the ravages of the boll weevil in the central and southern regions. High labor costs promote machine production which can be used more effectively in the Mississippi Valley and the Great Plains region.

The number of acres planted seems to follow closely the price situation of the preceding year. The growers, for example, seeded 47,100,000 acres in 1926 following the 19.6-cents-a-pound price received in 1925, and the 23-cents-a-pound price received in 1924. The 1926 crop, however, brought the farmers an average price of only 12.5 cents a pound. The result was that the farmers reduced their planting to only 40,100,000 acres in 1927. This low acreage was reflected in the price received for that season's crop, which was 20.2 cents a pound. The farmers promptly responded by planting 45,300,000 acres in 1928. The last column of Table 48 shows the effect on the average prices received during the period. These facts make it quite evident that the supply of cotton is elastic.

Cotton and the A.A.A.—The A.A.A. attempted, as with wheat and corn, to control production through limiting plantings. A processing tax was collected to finance the plan. Loans were made to the farmers so that the cotton crop would not have to be rushed to market. The producers received a benefit payment if they made the prescribed reductions.¹ For the crop year of 1934, approximately 1,000,000 cotton farmers agreed to remove 15,000,000 acres from production. This constituted a reduction of 38 per cent of the base acreage of cooperating producers. Under the unconstitutional 1934 law the number of bales allowed free of tax was set by the Secretary of Agriculture. Thus a total of 10,000,000 bales could be ginned free of tax during the crop year 1934–1935; a tax equal to 50 per cent of the central market price for $\frac{3}{8}$ inch Middling *spot* cotton was assessed on all cotton ginned in excess of the allowable amount. The amount produced was less than 9,640,000 bales, owing chiefly to the drought. Payments for the year were approximately \$117,000,000. The Department of Agriculture estimated that the 1933 program reduced

¹ The base acreage was the 1928–1932 annual average seeding. This is approximately 41,000,000 acres. The acreage reduction for 1935 was 35 per cent of the base. It was estimated that this would, under normal conditions, produce about 10,500,000 bales. The actual acreage seeded in 1934, as reported by the government, was 28,412,000. The estimate of the *New York Journal of Commerce* for 1935 was approximately 30,550,000 acres.

the production by 4,489,467 bales; in addition, 2,441,805 bales were optioned. The cotton farmers received a total of \$161,771,697 in adjustment payments and advances on cotton options as a reward for their cooperating with the government in its attempt to equalize supply and demand.

The 1933 reduction in acreage by the cotton states affected production in varying degrees. Virginia, for example, showed one of the largest percentages of acreage decrease of any of the states but had an appreciable increase in total production. Oklahoma, on the other hand, followed about the same acreage reduction but suffered a reduction in output of 66.5 per cent. The total reduction in output for the cotton states was estimated at 29 per cent; the acreage reduction brought about by the A.A.A. for the year was only 9.3 per cent. Twelve of the sixteen cotton states enjoyed a higher money return for the 1934 crop than for the 1933, while two suffered material decreases.¹ The weather man apparently was more effective than the A.A.A. in reducing the cotton output.

The Characteristics of the Producer, and His Methods.—Prior to the Civil War cotton was produced under relatively large-scale methods. Slave labor, plantation gins and stores, and large-scale financing were the characteristic features. Following this war, the plantation system was replaced by the small-scale farmer. There developed the independent gin company, the cotton yard, the town bank, and hardware and grocery stores to render the services that had formerly been performed on the plantation. Cotton is still largely picked by hand. Power machinery may be used to prepare the seed bed and to do the planting, ginning, and baling, but up to the present no satisfactory machine has been invented for picking. Many predictions have been made that man's ingenuity will soon solve this problem.²

There are approximately 2,000,000 cotton farmers in the United States. A large proportion of these are tenants, and many of them are colored.³ The typical producer knows little about cotton grades and the price that the various grades should sell for at any given time and place. The large planters are able to borrow money on a business basis and to plant, cultivate, harvest, and sell in a fairly effective manner. A large number of the small farmers, and especially the tenants, do not practice diversified farming and crop rotation. They have to borrow money to live on and to finance their production. The more successful may be able to borrow money from the local bank; a large number, however, buy

¹ University of Alabama, *Business News*, October, 1934.

² By using a "sled" a man can pick as much in 7 hours as it would take him 70 hours to pick by hand. The sled, however, picks all bolls, the green and spoiled as well as the ripe. The mechanical cotton picker recently invented will pick as much cotton in 7½ hours as a hand picker can pick in a season.

³ Normally about 53 per cent of the cotton of the South is grown by tenants.

their food, clothing, and supplies from the local merchants and then liquidate their indebtedness by selling their cotton to these merchants. This situation obviously places the farmer in an inferior bargaining position when selling time comes.¹ Many of them are forced to sell as soon as the crop is harvested. This large volume of cotton moving into the central markets in a short period of time tends to depress the farm price and to promote speculation among the middlemen. The A.A.A., in order to meet this situation and to raise prices, loaned the growers a maximum of 10 cents a pound on the 1933 crop; the amount of the loan was raised to 12 cents a pound for the 1934 crop. This was above the price at which the 1934-1935 crop could be sold; as a result by the beginning of August, 1935, the government controlled 5,000,000 bales of spot cotton and held 1,000,000 bales of future contracts.

The 1935 cotton plan, which was announced the latter part of August, 1935, provided a 10-cent loan to farmers and guaranteed that the average returns to the growers would not be less than 12 cents per pound for cotton grown in 1935. The payments of the government to the farmers were "to equal such differences if any, as may exist between 12 cents and the average price of $\frac{7}{8}$ -inch middling cotton . . . during the period from September 1 to January 1."² A loan of 10 cents per pound at the farm, without recourse to the borrower, was offered by the Commodity Credit Corporation on $1\frac{3}{16}$ -inch low middling cotton or better. The Reconstruction Finance Corporation supplied the Credit Corporations with the necessary funds. These loans were limited to the cooperating farmers. This plan permitted the price of cotton to approach more closely the world price and at the same time to maintain the high price to the farmer. The difference, however, will probably have to come out of the treasury of the United States.

Some of the Characteristics of the Product.—Cotton, as it comes from the field, is so bulky that efficient marketing necessitates immediate ginning and baling. An ordinary bale of cotton is, roughly, 54 inches long, 45 inches high, and 27 inches wide and weighs, including bag and wire, approximately 500 pounds, or $12\frac{1}{2}$ pounds per cubic foot. Cotton to be exported, stored for some time, or transported a long distance is compressed into bales having a density ranging from 24 to 35 pounds per cubic foot. Cotton that is properly picked, ginned, baled, and protected from water is relatively non-perishable.

The more important types of American cotton are sea island, American Egyptian, upland long staple, and upland short staple. The value of any particular bale depends upon the grade, color, and length of staple. The

¹ Many of the problems of the southern cotton farmer arise from an unwise utilisation of land. He has difficulty in thinking in any other terms than cotton.

² *New York Journal of Commerce*, Aug. 23, 1935.

Universal Standards Act, a law passed by Congress in 1923, establishes a set of nine grades for American upland white cotton. These grades are now recognized and used throughout the world. Such factors as the brightness of the sample and the amount of foreign matter determine the grade. While the quality and length of the fiber are important factors in determining the spinning value of cotton, little attention is paid to these qualities in determining the grade. Each grade has both a name and a number, as follows:

TABLE 49.—COTTON GRADES AND PRICE DIFFERENTIALS (WHITE)

Grade number	Name	Amount "on" or "off" the basis price	Grade number	Name	Amount "on" or "off" basis price
I.	Middling fair	0.69 on	VI.	Strict low middling	0.38 off
II.	Strict good middling	0.57 on	VII.	Low middling	0.82 off
III.	Good middling	0.46 on	VIII.	Strict good ordinary ¹	1.30 off
IV.	Strict middling	0.31 on	IX.	Good ordinary ¹	1.75 off
V.	Middling	Basis			

¹ Not deliverable against future contracts.

The price of cotton is quoted on grade V. *Middling* as a *basis*. The grades above this are quoted at the *basis price* plus so much *on*; grades below are quoted the basis minus the *off* amount. Thus the price quoted in the *New York Journal of Commerce*, August 12, 1935, for grade V. *Middling*, White, was the basis price, *i.e.*, 11.50 cents a pound; the price for grade VII. *Low Middling*, White, was the basis price minus 0.82, or 0.82 *off*; the price for I. *Middling Fair*, White, was the basis price plus 0.69 or 0.69 *on*. Premiums are paid for staple $1\frac{5}{16}$ inch long and longer.

Cottonseed and linters are joint products with the fiber. The cottonseed at one time just about paid for the ginning; now the farmer may receive a substantial return for the seed from a single bale. This is due to the many uses made of cottonseed oil. About 1,500 pounds of cotton in the seed, as it comes from the field, is required to make a 500-pound bale of ginned cotton. The thousand pounds represents approximately the weight of the seed.

Methods of Marketing Cotton.—The cotton farmer may sell *direct* to the mill. The amount sold in this way, however, is insignificant. The larger portion is sold through the *indirect method*. The mills prefer to purchase from merchants who buy "farm-run" cotton and sort it to meet the manufacturer's specific requirements as to grade and staple. While methods of marketing vary from section to section, there are a few well-defined methods. The producer can sell in the local or country market

to a merchant, bank, gin company, dealers' agent, or other country buyers. He may decide to dispose of his crop in one of the central markets¹ through a factor or commission house to representatives of mills, exporters, and other interests. There are various ways of expressing the terms of sale, the more important of which are *to arrive*, *f.o.b.*, *spot*, and *guaranteed through*.

Cotton growers have been active in organizing cooperative associations. The encouragement given to the cooperative movement by the organization of the Federal Farm Board tended to increase the volume handled by the cotton cooperatives. Cooperative marketing tends to increase the money returns to the producers through eliminating marketing steps, by presenting a well-graded product, reducing wastes from sampling, decreasing credit costs, securing equality of opportunity and the advantages of storing cotton in large quantities in bonded warehouses.² The A.A.A. dominated the situation from 1933 to the beginning of 1936.

Services Necessary and the Agencies That Perform Them.—The large-scale and centralized form of demand, together with the small-scale, widely scattered form of production, and the bulky, non-perishable, and unstandardized character of the product necessitate the performance of a number of specialized services. The cotton must be collected from the producers, ginned, baled, transported, graded, and stored. Specialized merchants have developed to sort the fiber into lots to meet the needs of specialized spinners; specialized bonded warehouses have been constructed to provide suitable storage facilities; the warehouse receipt serves as a basis for financing. A group of specialized middlemen has developed to perform the services incident to selling in foreign markets.

Cotton Markets.—There are four well-defined markets in which the title to cotton may pass from seller to buyer: the spinners', future, spot, and primary markets. The following statement suggests the nature and importance of each.³

Spinners' markets are located in or near mill centers and exist primarily to supply spinners' needs. Foreign spinners customarily have a market in the local mill town, but buy also through a broker in the import market. The personnel, methods of selling, and rules governing transactions in the various spinners' markets, domestic and foreign, vary greatly, owing to the wide divergence in local needs and in the services performed. Price making in a spinners' market is largely concerned with bargaining on the "basis" or parity between spots and futures. Prices are made in American markets in terms of New York or New Orleans futures.

¹ The leading central markets are New Orleans, New York, Chicago, Galveston, Corpus Christi, and Houston.

² FILLER, H. C., *Cooperation in Agriculture*, pp. 242 ff.

³ Adapted from U.S. Department of Agriculture, Bull. 1444.

A *cotton futures market* is a place where cotton is bought and sold for future delivery on a rigidly standardized contract. The futures markets at New York, New Orleans, and Chicago in this country and at Liverpool, Bremen, Havre, Bombay, and Alexandria abroad are dealers in cotton for future delivery, or "futures." The futures market is essentially a price-making organization, and every discernible influence affecting supply or demand is reflected in this market. An adequate understanding of cotton marketing necessitates familiarity with the organization and methods of the futures exchanges.

Price making in the futures market operates through the purchase of cotton for consumption and for speculation. On the supply side, it operates through the sale of cotton for immediate delivery or delivery in a named future month. Prices rise or fall with changes in the minds of traders in cotton as to the relationship between demand and supply.

The *centralizing*, or *spot markets* are the great reservoirs of spot cotton. Nearly every bale of cotton grown passes through one of these markets, and dealers and merchants draw upon them directly in supplying the needs of the mills. These markets are scattered throughout the Cotton Belt and function as assembling points and gateways through which large volumes of cotton move toward domestic and foreign mills. An important service rendered by the spot market is the classing and assembling of cotton in even-running lots as required by spinners.

The *primary market*, or farmers' market, is the place where the grower meets the buyer. Quite often this market is a wagon market near the public square, where the farmer offers his cotton for sale to the highest bidder as soon as it has been ginned. The facilities in this local market differ widely, and the buyers and sellers usually operate quite independently. The two main problems of the primary market grow out of the limited volume of business and the inability of the farmer to know the comparative value of his product.

Selling Cotton.—The primary or farmers' market is in the local town where the producer can usually find some buyer willing to pay cash for his crop. The following quotation gives an interesting picture of what takes place in one of these markets.¹

The farmer picks the cotton and either puts it immediately into a wagon that is standing in the field, or piles it on the ground. He usually takes the seed cotton to the gin just as soon as enough is obtained to make a 500-pound bale, but in a busy time he may wait until several bales are gathered before hauling it to the gin. Usually the next step after ginning is to sell to a local buyer. If the farmer considers the market satisfactory, or if he is being pressed for money to settle obligations (the latter being the more usual motive), he immediately reloads the cotton on his wagon and drives to market, often in the same town as the gin. If he does not care to sell at once, he will probably take his cotton home to hold until he has several bales to sell. Upon reaching the local market, the street buyers climb on the wagon, cut the bales on both sides, draw samples, and make a bid. The farmer may accept such an offer, but more than likely he will get bids from all other buyers in the market and finally sell to the buyer making the best

¹ PRATT, E. E., *International Trade in Staple Commodities*, Chap. I, pp. 30-31.

offer. He then hauls the cotton to the town cotton yard or warehouse or compress, where it is weighed by a bonded public weigher. The weigher gives him a ticket containing the weights of each of the bales, and the farmer returns to the office of the buyer, who gives him a check for the value of the cotton on the basis of such weights. The local buyer is likely, during the late evening after the day's buying is over, to communicate with an f.o.b. man in the same or in a near-by larger market and sell all the accumulated purchases of the day. The following morning he ships the cotton to the nearest compress for the account of the f.o.b. man and attaches the bill of lading to a draft on the f.o.b. man, depositing it in a local bank.

The f.o.b. man, in turn, either the same evening or as soon as possible, calls by telephone some exporter or domestic merchant in a port or central market and offers the cotton he has collected from street buyers during the day. He states the number of bales for sale and gives the description as to grade and staple. Perhaps several dealers make offers, and he accepts the highest. The next morning he has the cotton loaded and shipped to a compress at a concentrating point in accordance with the buyer's instructions. He then draws a draft on the buyer, attaches the bill of lading to it, and deposits it in the local bank which finances his transactions.

When the cotton arrives at the press, the buyer has it unloaded, classed, and stored in lots of even-running grade, staple, and color. If it has not already been compressed, he usually has it compressed before storage, in order to economize in space and to have the cotton ready for prompt shipment when needed. It now remains undisturbed until sold for export or for shipment to a mill.

The chief functions performed by the *cotton merchant* are buying and collecting, grading, storing, financing, assuming certain risks, and selling. The *cotton factor* is an expert salesman, possesses a large amount of market information, and gives financial assistance. He usually receives cotton on consignment, has it weighed, sampled, and placed in a warehouse. If his principal requires financial assistance before the cotton is sold, the factor permits the shipper to draw on him for from 70 to 90 per cent of the value of the shipment.

Basis of Sale.—Cotton is sold on the basis of *samples*, *types*, and *description*. When the sale is made on the basis of a sample, the seller—usually the factor, merchant, or commission man—displays a bunch of cotton weighing approximately a half pound taken from each side of the bale. The buyer judges the quality of the bale by examining the sample and has the right to expect that each bale will come up to or equal the quality of the sample. A sale by type is the delivery of cotton equivalent to a standard furnished by either the buyer or seller. This specimen is different from the sample in that it may be made up from one or several samples. It represents the qualities to which the shipment must conform. A sale by description is sometimes resorted to when samples are not available. The description specifies the grades and staples the buyer is to receive.

Sale in the Foreign Market.—American cotton reaches the European market by the American sellers consigning their shipments to merchants in Liverpool, by Liverpool and Manchester firms sending buyers to the United States, and through branch offices which American firms have established in England.

Handicaps of the Cotton Grower.—The system under which cotton has been marketed during the last twenty-five years has not been at all satisfactory. Much time and thought have been expended in analyzing the difficulties and in the search for remedies. The following quotation summarizes the outstanding handicaps under which the cotton grower operates.

The results of these three studies disclose conditions that might well be astounding to any serious investigator. For convenience the more significant of the conditions disclosed by these investigations may be grouped under six heads: (1) wide variations in prices paid for Middling cotton in the same market on the same date; (2) undue penalizing of the lower grades; (3) insufficient premiums for better grades, staples, and qualities; (4) unfair differentials in price between the Eastern and the Western section of the belt; (5) advantages gained through the farmer not knowing the exact grade, staple, and quality of his cotton; and (6) continuous and complete failure of competition in securing a fair price to the farmer for his cotton.¹

The cooperative plan of marketing has made some progress toward solving these problems, but much remains to be done. Many of the cotton growers do not seem to appreciate the possibilities for better results offered by the cooperative association.

Some International Complexities.—The price of cotton under normal conditions and in the long run is determined in the world markets, and not in the United States. Since we produce approximately 50 per cent of the world supply and export normally 55 to 60 per cent of our output, we have an important position in the industry. The very fact that we export such a large portion of our supply places us in a vulnerable position. We should have to eliminate almost 50 per cent of our production before we could get on a domestic price basis or we should have to pay bounties on exports before we could effectively raise prices by artificial means. As we reduce our domestic output in our attempt to raise the world price, other producing nations tend to increase their output. To the extent that they succeed they counteract and nullify our attempts.²

The processing tax on cotton raised considerable objection from consumers and manufacturers. Rather extravagant charges were made as to the effect of the tax on the prices paid by the consumer of cotton manufactured goods. It appears that the tax of 4.2 cents a

¹ MONTGOMERY, ROBERT H., *The Cooperative Pattern in Cotton*, Chap. I.

² Cf. Table 47 and p. 315.

pound on cotton equaled about 5 per cent of the retail price of a cotton shirt. It cost on the average about \$1.25 per capita annually, or \$5.00 for a family of four.¹ The processing tax accounted for 8.6 per cent of the total cotton textile mill expenses for lawn, 11.2 per cent for broadcloth, 12.5 per cent for print cloth, and 15.4 per cent for narrow sheeting.² The prices of cotton manufactured goods were raised also by the code provisions, which raised wages, reduced hours of labor, and provided other restrictions on production. The Japanese have been able to buy American cotton at the world prices, manufacture it into cloth, and sell it in the United States and other countries in competition with the American and European cotton goods manufacturers. They have been able to do this because of the long hours worked by labor in Japan, the low wages and taxes paid, and the greatly depreciated yen, which allows foreign countries to buy more Japanese goods with a smaller quantity of their own money, and the generally disorganized state of international trade. The American cotton farmer has benefited from this Japanese trade expansion since Japan has increased her purchases of raw cotton from the United States. It is not clear, however, how much has been lost through the American manufacturer's not being able to sell as much abroad and at home as formerly.

The Miscellaneous Group of Farm Crops.—The miscellaneous group of agricultural products comprises such goods as raw rubber, cacao, copra, raw sugar, tea, coffee, and tobacco. They are produced, typically, on plantations hundreds of miles from the major consuming centers. The marketing problems and practices vary widely among the members of this miscellaneous group. A number of these products, however, notably sugar, rubber, tobacco, and coffee, have been confronted with a common problem in dealing with over-production. The producers have tried to solve this problem through the control of production or the control of the flow of the product into the market. To this extent they anticipated the practices of the A.A.A. by several years. In each case the methods failed to produce the results anticipated and the plans were abandoned or greatly modified.

The marketing process followed in getting green coffee from the plantation to the roaster is used to represent this group of agricultural products. The analysis and discussion should be regarded as a case rather than as a typical illustration.

Marketing Coffee.—The coffee growers of Brazil, who normally produce approximately 70 per cent of the world's supply, were perhaps the first of the agricultural producers in modern times to secure the direct aid

¹ Editorial, *New York Journal of Commerce*, Dec. 17, 1934. Figures quoted from estimates by U.S. Department of Agriculture officials.

² *Business Week*, p. 9, Apr. 20, 1935.

of their government in manipulating prices and later in controlling supply through destruction of a portion of the commodity. They have been wrestling with their problems of production and marketing for many years. As late as 1935 the government had to abandon the scheme of supporting the price of green coffee on the level attempted because of the stimulation of production in other countries. The situation is quite comparable with the cotton problem in the United States. An interesting situation has developed in that Brazil has greatly expanded her cotton production as the United States has curtailed hers. This country cannot retaliate by producing coffee, however, owing to climatic limitations.

The demand for coffee is widespread throughout Europe and North and South America. The total average annual consumption is estimated near 2,750,000,000 pounds. The United States alone consumes twice as much as any other nation. This country quite probably accounts for as much as 40 per cent of the world's consumption. The per capita consumption in the United States is approximately 12 pounds a year.¹

The market for the coffee planter is in reality the roaster. The product is generally processed—i.e., roasted, glazed, and usually ground—before it reaches the consumer. The demand for green coffee on the part of the roaster, obviously, depends directly upon the demand for the roasted product. Coffee, as a beverage, depends for its popularity upon its flavor, which may be secured through skillful blending of different varieties; a stimulating effect; and a habit-forming tendency. Because of these factors the demand is fairly constant and quite inelastic.

While the demand for roasted coffee is decidedly small-scale, the demand for green coffee on the part of some roasters is large-scale. A large number of small roasters, however, are scattered throughout the country. There are several different kinds of roasters, the more important being those owned by the large food companies, chain stores, mail-order firms, wagon retailers, such as the Jewel Tea Company, wholesale grocers, and the independent roaster who sells under his own brands.

Characteristics of the Supply.—Green coffee represents a highly concentrated value and is relatively non-perishable. If it is kept dry, there is a tendency for the product to improve in quality with age. The coffee bean, as it comes from the tree, is of different sizes, shapes, and qualities. Grading is necessary in order to separate the undesirable from the desirable beans. The quality of the product seems to depend upon soil, climate, and weather conditions. Brazil is the world's largest producer of coffee, yet a quality that is generally regarded as superior comes from Colombia, Venezuela, and Java.

¹ In a survey made in 32 cities in which 10,000 individuals from 2,363 families were interviewed, it was found that 69 per cent of the individuals drank coffee. The United States imported 1,598,107,000 pounds of coffee during the year 1933-1934.

The grades of coffee are represented by name. The most important grade is Santos; other important grades are Jaya, Rio, Mocha, Bogota, Peaberry, and Blue Mountain. Green coffee is usually classified according to weight, grade, and age. Santos No. 4 serves as the basis for market quotations.¹ Coffee is divided into *types* for trading on the New York Coffee and Sugar Exchange.

In determining the type, the coffee is graded by the number of imperfections in it. These are black beans, broken beans, shells, immature beans (quakers), stones, and pods. For counting the imperfections, the black bean has been taken as the basis, and all imperfections, no matter what they may be, are calculated in terms of black beans, according to a scale which is practically as follows:

3 shells	}	= 1 black bean
5 broken beans		
5 quakers		
1 pod		
1 medium-sized stone		
2 small stones		
1 large stone = 2 to 3 black beans		

By this scale, a coffee containing no imperfection would be classified as type No. 1. The test is made on one-pound samples. If a sample shows six black beans, or equivalent imperfections, it is graded as No. 2; if 13 black beans, as No. 3; if 29, as No. 4; if 60, as No. 5; if 110, as No. 6; if more than 110, as No. 7 or No. 8, which are graded by comparison with recognized exchange types. Coffees graded lower than No. 8 are not admissible to this country.²

The Method of Production.—Coffee grows on small trees or bushes. The plantation owner cannot readily shift from coffee to some other crop or vice versa. His situation is quite similar to that of the orange or apple grower in this respect. He operates on a large scale. The volume of production is influenced by new plantings and weather conditions. The coffee planter specializes in coffee and typically produces no other product for market. The fact that a large portion of the coffee crop normally leaves the plantations during the period from September to December necessitates the provision of adequate storage facilities at various points along the route to the roaster. The State of São Paulo depends almost entirely upon coffee for its prosperity, and 50 to 60 per cent of the total exports of Brazil is coffee.

Attempts at Control.—The producers of coffee, in common with so many other producers of agricultural products, have suffered greatly from over-production. The government of Brazil at one time attempted to restrict the planting of coffee trees. This was a slow and uncertain method to remedy an existing evil. A so-called valorization plan was

¹ RHODES, *op. cit.*, p. 549.

² *Ibid.*, pp. 553 ff.

tried next. The government bought coffee and withheld it from the market. The amount in the hands of the government soon became enormous, so government purchase was abandoned and the coffee turned over to trustees. With restricted exports, limited sales, and a reduced output, the price of coffee by 1910 advanced sharply. During the drastic deflation following the close of the World War the price of coffee fell to an unsatisfactory level.¹ A valorization plan in which the government or its representative bought up and held in storage large quantities of the product was again attempted. Under this plan prices advanced sharply from the crop years 1921–1922 to 1928–1929. The rapid accumulation of unsold stock and the greatly increased production in other coffee-producing countries finally brought about a drastic reduction in coffee prices during the depression. The plan in its later development was effective in controlling the rate of flow of coffee from São Paulo to the world coffee markets, but it failed to control the volume of production and to prevent the accumulation of large stocks of coffee in Brazil. This condition broke prices and forced abandonment of this particular scheme. Finally, strict regulation of the industry through cooperation of the federal and state governments brought temporary relief. New plantings of trees were prohibited; deliveries and shipments from the coffee ports were reduced by a system of free and retained quotas; and large quantities of the product were destroyed. The 1933–1934 crop, however, was the largest to that date ever harvested. The government purchased 40 per cent of the crop and destroyed it so as to keep it off the market. Brazil is reported to have destroyed 8,266,000 bags of coffee during 1934; a total of 34,108,000 bags—equal to more than two years' production—was eliminated from June, 1931, to January, 1935, in the attempt to reduce the surplus and maintain prices. The ultimate outcome is, however, uncertain. The higher prices temporarily secured encouraged increased plantings and production in other countries with the result that early in 1935 the Brazilian government allowed prices to decline so as to discourage this actual and potential competition. The production in Brazil, according to the reported official estimate, in 1934–1935 was 14,102,000 bags. The preliminary estimate of the 1935–1936 crop was 18,000,000 to 20,000,000 bags. Production during the last period of control increased materially in other countries of South and Central America and in East Africa.

Marketing Practice.—The planter usually ships his coffee to a commission house in Santos or in Rio de Janeiro. Practically all of the Brazilian coffee exported passes through these two ports. The commis-

¹ The spot price of Rio No. 7 on the New York market in July, 1913, was 9½ cents; in 1919 it was 25 cents; by March, 1921, it had fallen to 5¼ cents (*cf. Brown, op. cit., Chap. IX*). It was 5½ cents Mar. 14, 1931, and 6½ to 7 cents on Jan. 29, 1936.

sion men assemble, grade, and store the green berries. They receive the coffee just as it comes from the plantation in various sizes, grades, and conditions. The commission men typically sell to exporters through brokers. The Brazilian Government at times in the past bought directly from the producers and acted as exporter.¹ An importer may, in some instances, buy directly from the commission house or, more rarely still, from the producer.

The practice among New York importers now is to buy coffee on either the basis of f.o.b. deliver steamer at loading port, or delivery c. & f. (cost and freight) or c.i.f. (cost, insurance, and freight), port of destination. Payment is made by letter of credit on a New York or London bank, entitling the exporter to draw a 90 days' sight draft against the shipping documents.¹

The exporter in Brazil typically sells through brokers in the leading coffee importing centers—in the United States, New York, New Orleans, and San Francisco.² These importing brokers may sell to jobbers who roast and blend the coffee and sell it to wholesale grocers; to other brokers who are acting for independent roasters, large wholesalers, and large-scale retailers. The last may buy directly from the import broker. The frequency of purchase, volume of purchases of the buyer, and, to some extent, his location determine whether any intermediaries are used. One of the large chains is reported to be the world's largest importer and roaster of coffee.

Coffee exchanges where both spot and future transactions are carried on are located in New York City and Havre, France. The exchange performs an important service in collecting and disseminating information about the condition of the growing crop, quantity in storage, amount afloat, and market conditions, in addition to providing facilities for trading in futures.

Problems of Sugar Control.—The following quotation expresses in a summary form some of the marketing difficulties encountered by the Cuban sugar industry and some of the steps taken to meet the situation.

Since 1925 Cuba has vainly sought means to stabilize the sugar industry. Alone and by means of agreements with other sugar-producing countries, Cuba has attempted to reduce production to the level of consumption. Inadequate international co-operation has limited the success of such programmes, but Cuba has actually reduced output from a peak of 5,189,000 long tons in 1924-25 to 2,000,000 tons in 1932-33, and 2,300,000 tons in 1933-34. In return for the tariff preferences granted by Cuba on practically all dutiable articles, until recently Cuba has received no major considerations from the United States. In fact, the protective tariff has permitted a steady expansion in sugar production

¹ Rhoads, *op. cit.*, p. 554.

² Chicago is an important coffee-roasting and distributing center.

in the insular possessions and in the relatively inefficient beet sugar industry. The present administration has recognized this situation and the tariff on Cuban sugar was reduced from \$2.00 per cwt. to \$1.50 per cwt. on May 9, 1934. On August 24, a treaty was signed by Cuba and the United States providing for a substantial degree of reciprocity and for a reduction to 90¢ per cwt. in the American tariff on the amount of Cuban sugar admitted under the quota allowed by the Agricultural Adjustment Administration. Recently, sugar prices in the United States have risen substantially and with the assurance of an annual quota for the United States, Cuba will be able to adjust production to a known market. Such an adjustment should permit the re-establishment of moderate stability in the Cuban sugar industry.¹

Some Problems Met in Marketing Rubber.—The United States holds a position in the rubber industry similar to that held in the coffee trade in that this country furnishes the greatest volume of demand for raw rubber and at the same time produces none of the raw product. The manufacturers of rubber products have to depend on two entirely different groups of producers for their crude rubber supply—the natives, who produce in small quantities in a crude way, and the European- or white-owned plantations, which produce in units of varying size but use machinery. This latter group furnishes the better grade of product.

The system of marketing rubber does not bring close contact between producer and user. The plantations typically sell their rubber through agents or brokers. Only a very small minority sells direct to the manufacturer. Rubber is graded and sold on the market on the basis of appearance; the actual requirements of the users are not given much consideration.

For the purpose of improving the average quality of the plantation output, the Department of Agriculture of the Federated Malay States suggested in 1935 that the users' requirements be considered during the meeting of the American Chemical Society. The requirements proposed for consideration were

1. Uniform Rate of Vulcanization.—To produce stocks of uniform strength and stiffness.
2. Uniform Age Resistance.—To produce stocks which will have satisfactory endurance.
3. Cleanliness.—To eliminate washing of rubber and improve quality.
4. Freedom from Deleterious Materials.—To eliminate danger of premature deterioration.
5. Freedom from Diluents.—To maintain high quality and uniform properties.
6. Uniform Plasticity.—To facilitate processing.
7. Softer Rubber.—To eliminate costly plasticizing process now in use.
8. Better Packaging.—To facilitate handling and insure cleanliness.

¹ Royal Bank of Canada, September, 1934.

9. Lower Water Absorption.—Important for special purposes.

10. Light Colored Sheet.—Plastic material for light colored articles.¹

The Marketing of Live Stock.—The economic significance of the live-stock industry in the United States is indicated by the gross income received by the producers from the sale of the animals and the products, the number of farmers engaged in production, and the geographical distribution of the industry. The American farmer enjoys a large income from the production and sale of a varied aggregation of domesticated animals and products derived from live stock. The following table indicates the gross income received by the American farmer from these sources during the period indicated:

TABLE 50.—GROSS INCOME FROM LIVE STOCK AND THEIR PRODUCTS¹

Year	Gross Income
1926	\$6,012,000,000
1927	5,799,000,000
1928	6,066,000,000
1929	6,507,000,000
1930	5,636,000,000
1931	4,222,000,000
1932	3,043,000,000
1933	3,111,000,000*
1934	
1935	

¹ U.S. Department of Agriculture, Yearbook 1935, p. 672.

* The figures for 1933 do not include rental and benefit payments.

There are more than 6,000,000 farmers scattered throughout the United States producing food animals for the foreign and domestic markets. Three-fourths of the marketable live stock of the country, however, is produced west of the Mississippi River, while the largest meat-consuming centers are east of the river. A total of 20,000,000,000 pounds of meat—a new record—was consumed in the United States in 1934.² The problems encountered in marketing live stock and the various kinds of animal products are quite distinct from those encountered in selling farm crops. The problems of marketing live stock differ widely, for example, from those associated with the selling of dairy products, wool, and eggs.

The marketing procedure followed in the marketing of hogs is used to illustrate the marketing process as it applies to the marketing of live stock, while the marketing of dairy products is used as a case representing the animal-products group.³

¹ Statement by G. A. Sackett of the Goodyear Tire and Rubber Company. Quoted in the *New York Journal of Commerce*, Apr. 24, 1935.

² The per capita consumption of lean meat and fish for the period 1920–1933 was 133 pounds.

³ See Chap. XI for dairy products.

The important position held by live stock as distinct from that held by the products is indicated in Table 51, which shows the gross income received by the producers from the sale of hogs, cattle, and sheep for the years indicated.

TABLE 51.—GROSS INCOME RECEIVED FROM THE SALE OF HOGS, CATTLE, AND SHEEP¹

Year	Gross Income
1926	\$2,922,000,000
1927	2,664,000,000
1928	2,727,000,000
1929	2,805,000,000
1930	2,448,000,000
1931	1,719,000,000
1932	1,123,000,000
1933	1,186,000,000
1934	
1935	

¹ U.S. Department of Agriculture, Yearbook 1935, p. 672.

The drastic decline in income after 1929 was due to the falling prices rather than to a decline in the physical volume of sales. In 1931 approximately 9,308,270 cattle weighing 8,787,382,000 pounds were marketed; the figures for 1933 were 8,978,200 and 8,507,018,500, respectively. Approximately 5,503,500 calves were sold in 1931 and 5,087,000 in 1933. The number of sheep and lambs sold in 1931 was 20,445,000; in 1933 the number was 18,675,000. The value of poultry slaughtered and dressed in factories was \$130,161,230 in 1929; the value was \$97,560,000 in 1931, a decline of 25 per cent from 1929; the value was \$66,153,000 in 1933, a decline of 32.2 per cent from the 1931 figure.¹

The Marketing of Hogs.—The gross income normally received by the farmers of the country from the sale of hogs is larger than that received from any other one agriculture product. Almost 49,525,000 hogs weighing 11,333,000,000 pounds were slaughtered in 1931, compared with 50,241,000 weighing almost 11,500,000,000 pounds in 1933.² These figures represent substantial increases over 1928 and 1929.

Characteristics of the Demand for Hogs.—Pork is utilized as a substantial food product among millions of people in Europe, Australia, Asia, and the Americas. Pork is taboo, however, among the orthodox Jews and Mohammedans. The demand for pork products centers in the large industrial cities. Hogs in large numbers are slaughtered yearly on the farms of the country and consumed there. With the rapid growth

¹ 1933 *Census of Manufactures*. More than 15,000,000 head of cattle and 9,000,000 calves were shipped or slaughtered locally in 1933.

² More than 58,000,000 head of hogs weighing in excess of 13,000,000,000 pounds were slaughtered locally or shipped during 1933; 6,411,000 head weighing more than 443,000,000 pounds were purchased by the A.A.A.; and 15,213,000 head weighing in excess of 3,525,000,000 pounds were slaughtered on farms during 1933.

of cities and the development of refrigeration, a larger and larger portion of the farm production is being shipped to markets where the animals are slaughtered and sold as fresh meat or further processed and sold as cured meat. The loss in weight in slaughtering is indicated by the following figures: in 1933 the average weight of the live hog was 228 pounds; when dressed the average weight was 167 pounds, a loss of 61 pounds; the figures for 1931 were 229 and 169 pounds. The demand for swine is expressed through two important agencies, the *meat packer* who buys the live animal, slaughters it, and prepares the carcass to meet the wants of the buyers;¹ and the *stockman* who buys the young animal for further feeding so as to put it in better condition for the packer.²

The demand for pork products is fairly constant. The fresh cuts are eaten extensively during the cool months, and the cured parts, such as bacon and hams, are eaten in larger quantities during the warmer months. The average per capita consumption of pork in 1927 was 68 pounds; in 1928 the average consumption rose to 74 pounds. The consumption of pork is affected, to some extent, by the price of beef. Thus when the price of beef is high relative to pork, the consumer eats a larger proportion of pork products. If the price of beef drops materially, less pork is bought and more beef. During a part of 1934 the price of beef was relatively much lower than the price of pork; as the price of pork rose the demand shifted to beef. The effect of the drought, which at first produced an over-supply because of forced selling, later caused a shortage of both cattle and hogs. By the first of 1935 the prices of both beef and pork had gone up so much that consumers began to complain.³ The demand for these meat products tended to display its elastic quality by shifting to other products used as substitutes. The consumption of meat is greatly reduced in some localities on certain religious holidays—especially during Lent, on Ember Days, and on Fridays.

Since large groups of people regard meat as a necessity, they want it sold in stores that are conveniently located. Many grocery stores have established meat markets so as to meet this desire of the consumer. The quick-freezing process, together with the new type of store refrigerators,

¹ In addition to the fresh cuts, such as loins, shoulders, and ribs, some of the meat is made into sausages, lard, and bacon; the hams are smoked, and other parts salted or pickled. The non-edible portion is manufactured into a large variety of by-products. Approximately 90 per cent of the beef in this country is consumed fresh, 3 per cent is frozen, 3 per cent cured, and 4 per cent canned.

² There is, in addition, an important demand for pure-blood animals for breeding purposes. This is a small-scale demand.

³ By the middle of August, 1935, the price of hogs on the Chicago market was above \$12 a hundred which was the highest price since 1926. Consumers throughout the country were "striking" and demanding lower prices. The shortage in supplies which caused the great increase in price over 1934 was due to the activities of the A.A.A. and to the drought.

makes it possible to sell fresh meat products in a large number of the 400,000 (more or less) retail food stores. The growth of the combination food store, as was stated in an earlier chapter, was rapid during the period 1929-1934.

Characteristics of the Supply Factors.—Since the producer typically sells his hogs on the hoof, the product, in this form, is fairly large and bulky. It is in many respects highly perishable. The modern heavy fat hog must be cared for carefully during its transportation from the farm to the packing house. Profits are greatly affected by disease, weather conditions, and accidents during shipping. The supply of hogs is much more elastic than that of cattle.

Live stock, as it leaves the farm, represents a wide range of characteristics.

Some possess excellent conformation, whereas others are ill shaped and rough; some are fat and others are emaciated; some are very young and others old; some heavy and others light; and, finally, some represent the highest degree of quality; whereas others are extremely deficient in quality.¹

It is the function of the marketing process to bring this great variety of animals into such a situation that the people who can utilize them to the best advantage may have an opportunity to buy them. To accomplish this economically, the live stock should be assembled into groups on the basis of certain significant characteristics. The process of classifying animals according to predetermined standards is known as *grading*.

Economic Value of Grading.—The grading of live stock before sale accomplishes four major purposes.

(1) It enables the buyer to get the animals he needs without buying some for which he has no use. (2) It makes possible an accurate determination of values. (3) It enables the producer to sell his live stock strictly on its merits. (4) It makes possible accurate and intelligible market reporting by providing a name or label for each group and having the meaning of such group names clearly understood by all interested parties.²

Table 52 gives the established classes and grades for hogs. There are five major classes. Three of these may have two sub-classes, i.e., slaughter and feeder. There are, on the basis of use, four classes, viz., butcher, bacon, packing, and roasting. The weight classifications and grades are given in the last two columns.³

Conditions of Production.—Hogs are produced on a small scale. It is estimated that no less than 5,000,000 American farmers, scattered

¹ "Market Classes and Grades of Live Stock," U.S. Department of Agriculture, Bull. 1360.

² *Ibid.*

³ U.S. beef grades are prime, choice, good, medium, and common; and the two sub-grades, cutter and low cutter.

TABLE 52.—SWINE CLASSES AND GRADES¹

Class	Sub-class	Use selection	Weight selection, pounds	Grade
Barrows and gilts.....	Slaughter	Butcher	Lightweight, 130-160	1, 2, 3, 4, 5
			Light, 160-200	A1, 1, 2, 3, 4
			Medium, 200-250	A1, 1, 2, 3, 4
	Slaughter	Bacon	Heavy, 250 up	A1, 1, 2, 3
			Heavy, 210-225	1, 2
			Medium, 180-120	A1, 1, 2
Sows.....	Slaughter	Packing	Light, 160-180	1, 2
			Light light, 130-160	1, 2, 3, 4, 5
			Light light, 130-160	1, 2, 3, 4, 5
	Feeder and stocker	.....	Light, 250 down	2, 3, 4
			Medium, 250-300	2, 3, 4
			Heavy, 300 up	2, 3, 4
Stags.....	Slaughter	.....	Light, 175 down	2, 3, 4, 5
			Medium, 175-250	2, 3, 4, 5
Boars.....	Slaughter	.....	Light, 350 down	2, 3, 4, 5
			Heavy, 350 up	2, 3, 4, 5
Pigs.....	Slaughter	Roasting	All weights	
			25 down	1, 2, 3, 4, 5
			Light, 60-100	1, 2, 3, 4, 5
	Feeder	.....	Heavy, 100-130	1, 2, 3, 4, 5
			Light, 70 down	1, 2, 3, 4, 5
			Medium, 70-100	1, 2, 3, 4, 5
			Heavy, 100-130	1, 2, 3, 4, 5

¹ PLUMB, C. S., *Marketing Farm Animals*, p. 208.

throughout the forty-eight states, raise hogs.¹ The bulk of the production, however, centers in the corn belt. The economical production of hogs depends upon an abundant supply of corn. The volume of production seems to go through rather well-defined cycles of approximately four years in length. Large production brings low prices, which leads farmers to curtail production; the reduced supply causes prices to rise again, which in turn seems to stimulate production.

Hog-corn Ratio.—There is a decided seasonal element in the production and marketing of hogs. Slaughter is greatest in November, December, January, February, and June; it is least in August and September.

¹ Swine travel, on the average, 250 miles in going from the farm to the consumer; cattle, 650 miles; and sheep, 800 miles.

Production is greatly influenced by the hog-corn ratio, *i.e.*, the relationship existing between the price of corn and the price of live hogs.¹ When the price of corn is low compared with the price of hogs, farmers find it profitable to feed corn to swine, so supplies of pork tend to increase. When the price of corn is high, farmers usually find it more profitable to sell the corn. Farmers in the corn belt really market their corn in the form of pork. There was a favorable hog-corn ratio from 1925

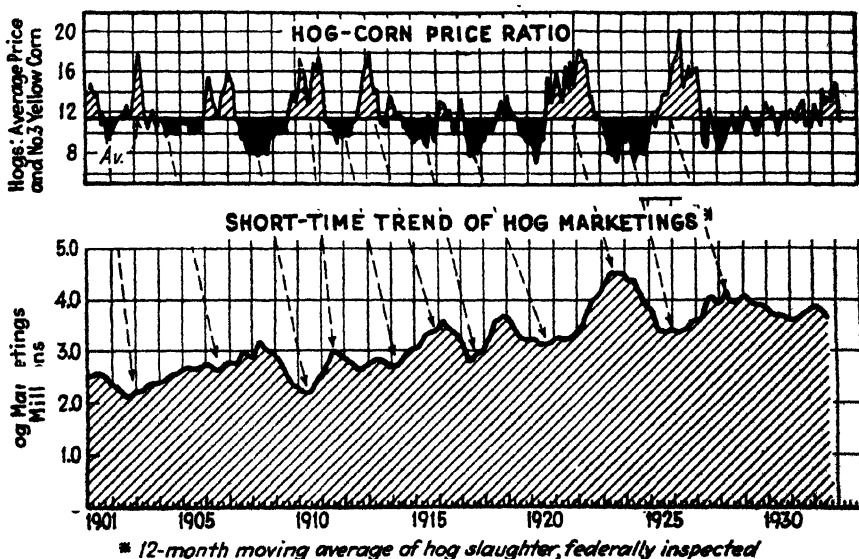


CHART IX.—Hog-corn price ratios and hog marketings.² The relationship between the price of hogs and the price of corn in a large measure creates the hog cycle. The upper part of this chart shows the deviations in hog-corn price ratio from its average. The lower part shows the changes in hog marketings (after eliminating the seasonal variations). A period of greater-than-average hog-corn price ratios is followed by an increase in hog marketings a year or two later, whereas a period of smaller-than-average ratios is followed by a decrease in marketings.

to the middle of 1927; the years 1928–1930 were relatively unfavorable. The droughts in 1933 and 1934 plus the A.A.A. reduced the supply of corn so that the price rose relatively to the price of hogs. The hog population declined 35 per cent from January 1, 1934, to January 1, 1935. The unfavorable hog-corn ratio during 1933 was one of the causes of the decline. During 1935 the price of hogs rose more rapidly than that of corn, thus producing a favorable ratio. Chart IX indicates the hog-corn ratios and hog marketings for the period 1901–1933.

¹ The hog-corn ratio measures the number of bushels of corn a hundredweight of live hogs will buy. The feeding ratio is favorable to producers when hogs will purchase a maximum of corn. When the price of 100 pounds of live hogs is above the price of 10 bushels of corn, the hog-corn ratio is said to be favorable.

² BURNHAM, C. A., "Economic Facts about the Hog Industry," *U.S. Department of Agriculture*.

Factors That Dominate the Hog Market.—The financial success of the hog industry depends upon the ability of the producers to adjust their supply to demand and to produce the classes and grades that are wanted by the consumer, as well as to see to it that the marketing process is economically performed. The dominant influences in the hog market, according to the U.S. Department of Agriculture, are¹

. . . (1) the supply of hogs on the market and expected to arrive on the market within the next few months, (2) the quantity of hog products in storage, (3) the general price level, (4) general business conditions, (5) the prices of alternative products. The general level of demand, both here and abroad, are both important, but ordinarily change only slowly.²

The A.A.A., Hogs, and Corn.—The farmers were unable, during the period 1930–1933, to sell their hogs at a satisfactory price. This meant that the corn-belt farmers were unable to market their huge corn crops at a price that covered costs of production. The general feeling developed that there were too many hogs and too much corn. The federal government decided to solve the problem by reducing the supply of hogs and the corn acreage. The farmers were offered benefit payments, according to the reduction made, from the proceeds of a processing tax collected from the packers. Some of the excess supplies of corn were to be held on the farms by the growers. The government made this possible by agreeing to loan the farmers an amount per bushel that was, in some instances, in excess of the market price.

The plan developed by the A.A.A. to reduce the hog supply was for the federal government to buy and slaughter 6,000,000 pigs which weighed not less than 25 pounds or more than 100 pounds each, and a large number of sows. The price paid for the pigs was above the market price.³ A rate as high as \$9.50 a hundred pounds was paid for pigs

¹ U.S. Department of Agriculture, *Bull.* 1440.

² According to a study published by the Armour Livestock Bureau, the seasonal price trends for the different kinds and grades of cattle vary considerably, thus (1) seasonal tendencies in price of the best grades of steers are just the opposite of the seasonal tendencies in the price of common steers. (2) Best prices for top grades of steers are reached in September and October, while yearly "lows" normally come in April and May. (3) Best prices for common steers are usually reached in May, and the lowest from August through November; the same is true for low-grade cows. (4) Best prices for stockers and feeders are usually reached in May; the lowest are reached in July, August, and December. (5) The number of low-grade cows in slaughter increases sharply during the fall months and reaches a decided peak in November. Price tendencies are the reverse of this movement to slaughter. Armour & Company, *Monthly Letter to Animal Husbandmen*, June, 1931.

³ The government actually bought 6,188,717 pigs and 223,247 sows due to farrow; 1,833,650 head of pigs were large enough to process into meat; the others were manu-

weighing 25 pounds. For hogs that weighed more than 100 pounds the government paid \$6.00 a hundred pounds. For sows due to farrow, weighing 250 pounds or more, a bounty of \$4.00 a head was paid; in addition, they were not subject to the customary dockage. As a result, the bounty actually amounted to about \$5.00 a head. The Emergency Relief Administration purchased the edible meat resulting from the slaughter at a price sufficient to defray the costs of processing, storage, freight, and handling; inedible portions were dumped or turned into grease. The success of the hog-reduction plan was reflected by high prices and large volume of imports during 1935. During the first seven months of 1935, the United States imported more than 67,000,000 pounds of meat products; 1,734,683 pounds of hams, shoulders, and bacon were imported during the period.

This method of reducing the supply of hogs was financed through a processing tax.¹ The plan was expected to remove 1,200,000,000 pounds of hogs from the fall and winter 1933-1934 supply. Since the supply of hogs is so closely related to the supply of corn, it was thought necessary to take measures to reduce the corn supply. Thus for every reduction of 10 head of hogs, 7 to 8 acres of corn land should be withdrawn. The A.A.A. came to the conclusion that the annual production of hogs should be reduced by 20 per cent, or a total of 10,000,000 head, while the corn output should be reduced by from 350,000,000 to 500,000,000 bushels. To make up for the farmers who refused to sign contracts, the individual farmers who did sign were asked to agree to reduce their corn acreage 20 per cent and their hog production 25 per cent. Thus the plan for 1934 called for a payment of a maximum of \$350,000,000 in benefit payments to farmers who agreed to follow the administration's plan. The individual farmer received 30 cents a bushel on the average annual production, secured on the land withheld from corn production, during the five preceding years. He received also \$5.00 a head on the number of hogs equivalent to 75 per cent of the average number produced and sold annually during the two preceding years. Approximately 1,160,000 farmers were reported to have agreed to the plan. When the farmers were asked to vote on the continuation of the plan for 1935, approximately 67 per cent of those who voted were favorable, but only about half of the producers eligible to vote did so.

The corn-hog producers received, in the form of government payments, \$101,945,334 to October 1, 1934. This amount is second only to that

factured into fertiliser, tankage, and inedible grease. This plan reduced market supplies about 1,000,000,000 pounds. This helps to explain part of the distressing shortage in meat supplies that occurred in 1935.

¹ The processing tax was \$2.25 a hundred pounds, April, 1935.

received by the cotton growers.¹ During the period \$45,951,873 was paid in purchasing surplus hogs. The A.A.A. contract for 1935 provided for a 10 per cent minimum reduction in corn acreage below the average for 1932-1933. The minimum for 1934 was 20 per cent. The reduction was limited to 30 per cent for both 1934 and 1935. The minimum reduction of hogs for 1935 produced for market was placed at 10 per cent below the 1932-1933 base; it was 25 per cent of this base for 1934. Farmers were allowed 35 cents a bushel on the estimated corn yield of the acres retired from production in 1935 compared with 30 cents received in 1934. These corn-abandoned acres may be used for any purpose except for growing field corn.

The *hog base* used is the average number of hogs produced for market from litters farrowed in 1932 and 1933. The 1935 contract provided for the payment by the government of \$15 a head on 10 per cent of the hog base. The earlier contract, as was stated above, provided for a payment of \$5.00 a head on 75 per cent of the hog base. The farmer, in order to receive the benefit payments, had, of course, to conform to all regulations and administrative rulings prescribed by the Secretary of Agriculture.²

Effect of the Processing Tax on Meat Prices.—Who paid the processing taxes? The packers collected the tax but probably paid very little if any of it out of what would otherwise have been their profits. When supplies are bountiful, as in 1933 and the greater part of 1934, there is evidence supporting the belief that the farmers pay the tax by being forced to accept a lower price for their shipments. When supplies are low, as was the case in 1935,³ prices rise drastically whether there is a tax or not. The consumer who continues to buy the high-priced products apparently then pays the major portion of the tax. Since the demand for meat is somewhat elastic, the consumer begins to substitute other products for pork. This practice tends to prevent the price from going still

¹ The A.A.A. had purchased, by Sept. 1, 1934, approximately 5,165,000 head of cattle in the drought area of the western states. Purchase and benefit payments totaling \$48,328,659 were paid to 278,577 farmers. The average price paid per head was \$13.54. The number of cattle finally bought was reported at approximately 8,000,000 head. The number of cattle on farms in the spring of 1935 were estimated to be only 11.2 per cent lower than the year before, yet prices were almost double those of the preceding year. The number of cattle and calves on farms Jan. 1, 1935, totaled 60,667,000 compared with the ten-year average of 61,257,000. The number on Jan. 1, 1934, was 68,290,000, an all-time peak. Storage holdings of beef in public warehouses and packing plants on May 1, 1935, were 78,000,000 pounds, or 7 per cent greater than the previous year, and 58 per cent greater than the five-year average for May 1. The 1935 holdings were exclusive of the holding of the F.S.R. Corporation. These surplus supplies were rapidly depleted during 1935.

² The contract contained provisions barring the signers from assigning any of their rights to payments under the contracts.

³ The hog supply for 1935 was approximately 35 per cent below normal, the lowest in fifty years. Prices rose 125 to 180 per cent above those of a year earlier.

higher. The grower thus does not get so high a price as he would otherwise.¹ The processing tax was equivalent according to some estimates to about 4½ cents a pound on pork products.

Methods of Selling.—The producer of hogs sells them by various methods. He sells directly to the packers or to local butchers, and he may even slaughter some and sell the carcasses to his neighbors; he consigns shipments to commission men in the central market; he sells to country buyers in the local markets; and, finally, he sells through cooperative associations. The choice of method used depends upon a number of factors, such as the volume of production, distance from market, relation of prices in the various markets, freight-rate structure, membership in a cooperative association, and the alertness of the farmer.

Transportation.—Some farmers raise enough hogs to ship in carload lots; if so, they have a wider choice in the selection of methods of transportation. A large number of farmers, however, do not produce in carload lots. Those farmers living near packing centers may deliver less than car lots by means of trucks. A large number of hogs are so delivered to some of the smaller central markets in the corn belt, such as Indianapolis, Evansville, Omaha, East St. Louis, and Detroit. Chicago receives relatively few delivered by truck, while Kansas City receives a large number delivered in this manner. There has been, however, a rapid increase in the number of live stock delivered by truck during the last few years. The total number delivered by truck to 17 large marketing centers increased from 22,894,316 in 1932 to 29,542,873 in 1933, an increase of 29 per cent, while the total number delivered by rail declined from 33,531,000 to 31,077,867, or 7.3 per cent. The following live-stock market centers received more live stock by truck than by rail, with increases in truck deliveries in 1933 over 1932 varying from 21.8 to 51.1 per cent: Cincinnati, East St. Louis, Indianapolis, Louisville, Oklahoma City, Omaha, St. Joseph, Sioux City, Sioux Falls, and Wichita. Truck deliveries to Chicago increased 64 per cent, while rail shipments declined 2.4 per cent, although rail shipments were still almost four times as large as truck shipments. Truck shipments to Portland, Ore., declined 11.6 per cent, and rail shipments declined 4.7 per cent. Rail and truck shipments to Milwaukee increased 0.7 and 17.8 per cent, respectively; to Sioux City, 14.3 and 21.8 per cent; and to Sioux Falls, 68.4 and 21.7 per cent. Rail shipments to Oklahoma City declined 37.2 per cent, while truck shipments increased 51.1 per cent.²

¹ The weighted average prices per 100 pounds received by the growers were 1925-1926, \$11.55; 1928-1929, \$9.28; 1930-1931, \$6.95; 1932-1933, \$3.36. The price Dec. 15, 1933 was \$2.92. After the drought, prices rose rapidly to above \$12.25 in 1935; this price plus the \$2.25 processing tax was equivalent to \$14.50 a hundred pounds.

² *Automobile Facts and Figures*, 1934 edition.

Special stock cars are provided by the railroads for the transportation of live stock. The railroad companies usually allow an attendant free transportation while accompanying a carload of stock to market.¹ The transportation company makes out a waybill, indicating the shipper, the destination, and the consignee. The owner must sustain all losses due to death of animals from natural causes, trampling, and smothering, when the transportation company has not been negligent. Upon arrival at the market, the stockyards company unloads and yards the animals.² Later the commission men take charge of the hogs, offer them for sale, and render an account of sale to the shipper.

Marketing Functionaries.—The middlemen that operate in the central live-stock market are commission firms who may be independent organizations or belong to some cooperative association; yard traders; speculators; and scalpers. These market functionaries sell to the packers, order buyers, and speculators.

The centralized marketing system characterizes our live-stock marketing method. This system has many advantages and performs certain distinctive services; for instance, it furnishes an opportunity for establishing public price quotations, and it was instrumental in the establishment of grades and the development of definite standards for trading. There are, in addition, other advantages; thus the producer always finds in a central market a number of possible buyers,³ skilled salesmen ready to sell his stock, and published records of receipts and prices. It furnishes the buyer an assortment of classes and grades at a cost usually below that obtainable through direct buying in the country. The organization, development, and continuance of centralized markets depend upon the wide separation of the producer and the consumer of meat products. Conditions are changing somewhat with the increase in the density of population throughout the country.⁴ In many instances the cost of meat is increased by shipping the live stock to a central market and then shipping the products back to the points near where they were grown.

There have been developing, especially since 1921, small packers throughout the corn belt and in some of the eastern states. It is frequently more economical for the producer to sell direct to these local

¹ The leading live-stock markets are located in Chicago, Kansas City, Omaha, East St. Louis, South St. Paul, St. Joseph, Sioux City, Indianapolis, East Buffalo, Milwaukee, Denver, Fort Worth, Jersey City, Pittsburgh, Cincinnati, and Oklahoma City.

² The stockyards companies typically perform the following services: receive the animals, give them yard room, shelter, feed, and water; weigh them, deliver the stock to the buyer, and reload when the stock is to be shipped out of the market.

³ It is estimated that there are as many as six hundred potential buying agencies in Chicago.

⁴ Cf. Armour & Company, *Monthly Letter to Animal Husbandmen*, Vol. VIII, No. 12.

packers than to ship to the large central markets. It is often possible, in other words, to shorten the route of this food product to the consumer. An interesting development took place during 1935, with reference to some of these small local packers. The supply of animals declined drastically as a result of the drought and the activities of the A.A.A. Since these local packers had very small inventories accumulated from the low-price period of the previous year, they were unable to secure adequate supplies so that they could sell in competition with the large packers who had large inventories of meat products carried over from the low-price period and who were able also to realize a profit on their by-products. The result was that many small packers were forced to close. A number of the better ones were able to sell out to the large packers.

The producer is better informed and more interested about market conditions today than ever before, thanks to the radio, farm magazines, stock papers, and the efforts of the U.S. Department of Agriculture and many state agricultural colleges. The farmer who sells directly pays no commission fees, feeding, handling, and switching charges. There are disadvantages, such as a lack of volume and variety from which the buyer can select, and there is not a satisfactory situation for providing adequate price quotations. The percentages of direct shipments from Wisconsin, Minnesota, Iowa, Missouri, North Dakota, South Dakota, Nebraska, and Kansas, from 1920 to 1927, were as follows: 1920, 20.2 per cent; 1921, 23.4 per cent; 1922, 24.08 per cent; 1923, 24 per cent; 1924, 22 per cent; 1925, 24 per cent; 1926, 27.12 per cent; 1927, 32.58 per cent, according to a study made by Armour's Live-stock Bureau. It has been stated that "directs" cost the packers more than comparable live stock at their own local markets, yet less than those reshipped from other public markets and handled more than once.¹ The percentage of directs tends to increase as hog production increases in each cycle.²

Cooperative Marketing.—Dissatisfaction on the part of the producer with the prices received for his live stock has caused him to give considerable thought to ways and means of reducing the costs of marketing and of controlling the volume of production and the rate of flow to market. The cooperative association was developed for the purpose of attaining these objectives. The farmers, in addition to working for lower freight rates,³ have set up their own local shipping associations and organized cooperative selling agencies in the central markets to compete with the independent live-stock commission firms. As the volume of business handled by these cooperative agencies grew, they were able to

¹ Armour & Company, *Monthly Letter to Animal Husbandmen*, Vol. VIII, No. 11.

² *Ibid.*, No. 12.

³ It has been estimated that the freight rate averages 5.2 per cent for hogs, 5.9 per cent for cattle, and 5.9 per cent for sheep. The total selling costs equal 3.8 per cent for hogs, 2.7 per cent for cattle, and 3.3 per cent for sheep.

show a profit which was divided among the members. The rebate in some instances amounted to as much as 40 per cent of the regular commission fee. It is reported that for several years the Central Cooperative Commission Company of St. Paul handled from 33 to 50 per cent of all hogs marketed there and has recently averaged regularly above 40 per cent. At East St. Louis the cooperatives handled more than 40 per cent of all the live stock on the market during the first part of 1928. These and other live-stock cooperatives are doing much to reduce costs of marketing and to increase the producers' bargaining power through coordinating the activities of the cooperatives in the various markets. They promote the establishment of standard grades of live stock and the selling on orders received from the packers. The animals are sometimes gathered, by the cooperative association, at small concentration points near the place of production, where they are sorted and graded, thus saving the higher costs of the central market.

It appears, at present, that, while the direct method and the cooperative method of marketing live stock have very definite places in our marketing system, there is still an important, if not a dominant, place for the indirect method and the large central markets.

Future Trading.—The first carload of hogs to be sold for future delivery was sold on the Chicago live-stock exchange on March 1, 1930. It was a carload of standard lightweights for September delivery, at almost 50 cents a hundred pounds above top prices in the cash market. Several other carloads were sold the same day for April and May delivery. During the first ten months of trading in futures a total of 1,125 contracts for 80,000 head weighing 18,400,000 pounds were sold. About 16,000 hogs weighing 3,664,000 pounds had been delivered by January 1, 1931.¹ Future trading, it was believed, would furnish an opportunity for transferring and mitigating some of the risks of price changes. Experience seems to indicate that the supposed advantages were somewhat overstated.

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Questions for Discussion

1. What are the characteristic features of the demand for cotton? Of the supply? How do these affect the method of marketing?

2. Summarize the different possible methods of marketing live stock. When can each be used to best advantage? Indicate by specific illustrations the influence of the characteristics of the product, the producer, the method of production, the nature of the demand, and the markets in which the products are sold upon the method of marketing.

show a profit which was divided among the members. The rebate in some instances amounted to as much as 40 per cent of the regular commission fee. It is reported that for several years the Central Cooperative Commission Company of St. Paul handled from 33 to 50 per cent of all hogs marketed there and has recently averaged regularly above 40 per cent. At East St. Louis the cooperatives handled more than 40 per cent of all the live stock on the market during the first part of 1928. These and other live-stock cooperatives are doing much to reduce costs of marketing and to increase the producers' bargaining power through coordinating the activities of the cooperatives in the various markets. They promote the establishment of standard grades of live stock and the selling on orders received from the packers. The animals are sometimes gathered, by the cooperative association, at small concentration points near the place of production, where they are sorted and graded, thus saving the higher costs of the central market.

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¹ *Chicago Tribune*, Jan. 1, 1931.

3. "The wholesaling of farm products ready for consumption has features not found in the wholesaling of manufactured consumption goods." What are the chief differences?

4. "In nearly all popular discussions of freight rates and the farmers it is assumed that the farmer pays the freight both ways." What is the truth in the case?

5. "A very important factor in market distribution is the car-lot wholesaler." What is the nature of the service performed by the car-lot wholesaler?

6. Indicate, by diagrams, the "channels" through which each of the following products passes in reaching the ultimate consumer—cotton, coffee, poultry, hogs. Give logical reasons why the particular channels are used in each instance.

7. "The commission believes that the situation of the agricultural producer can be materially improved by (a) a standardization of production of crops; (b) developing better knowledge of the marketing and distributive processes; (c) the development of greater uniformity of products, grades, standards, and containers, together with an improvement in methods of handling of agencies in local, primary, and terminal markets; (d) the establishment of qualified and authorized agencies to arbitrate disagreements between the shippers and receivers as to value, condition, kind, grade, and quantity of commodities; (e) the development of adequate organized, and correlated terminal markets; (f) a more systematic utilization of warehouses; (g) the establishment of more adequate central wholesale markets; (h) converters of agricultural products adjusting production more definitely to the current consuming requirements of the public; (i) a better knowledge of the requirements of the consumer and a recognition of the fact that distributive agents can not function economically except as they maintain an even, continuous flow of merchandise through the channels of distribution; (j) wholesalers purchasing stocks which can be turned with economic frequency." Analyze each of these statements and indicate *how* and *why* they may lead to more effective marketing. Be specific by indicating the part the producer, middlemen, transporters, warehousemen, government, and consumers must play.

8. How did the A.A.A. attempt to solve the agricultural problems of 1933-1935? Do you believe the A.A.A. used the points mentioned above in developing its policy?

9. It has been estimated that approximately 60,000,000 acres of land, or 16.4 per cent of that under cultivation, is required to produce the agricultural products normally exported. What objections, if any, do you see to abandoning 1 acre in 6 or 7 so as to meet the problem of over-production, which became acute in the period 1928-1934? What proportion of acreage for the following crops would have to be abandoned: wheat, tobacco, cotton?

10. Can the agricultural surplus problem be satisfactorily solved by the following program? Justify your answer. (a) Promoting rapid increase in population; (b) moving some farmers to the city; (c) increasing per capita consumption of agricultural products; (d) withdrawing submarginal land from production; (e) making changes in technique of production; (f) using land now used for export products to produce products now imported.

11. Who paid the processing taxes—growers, manufacturers, merchants, consumers? Justify your answer.

12. How has the tariff policy of the United States affected the agricultural problem? (Consult *The American Farmer* and *The Export Market*, by Dowell and , for the last three questions.)

Assignment

1. Problem 1, p. 238. The Big Meat Packers—Wholesale Distribution (Review).
2. Problem 1, p. 321. Heegan Mills.

CHAPTER XI

MARKETING AGRICULTURAL PRODUCTS—DAIRY PRODUCTS—MILK

Purpose of this chapter: To analyze the operation of the forces of demand and supply in the milk industry, and to survey the major problems encountered in marketing dairy products.

Farmers throughout the country secure a large income from many different kinds of animal products. Some of the more important ones are eggs,¹ honey, dairy products, wool, and mohair. The marketing problems and practices vary widely among the members of this group so that no one product can be used as a representative illustration. Since dairy products, *i.e.*, milk, butter, cheese, and ice cream, are familiar to all and at the same time are the source of the greatest income to the farmer, we shall use this class as a case.

TABLE 53.—FARM GROSS INCOME FROM DAIRY PRODUCTS¹

Year	Gross Income
1926	\$1,805,000,000
1927	1,911,000,000
1928	1,994,000,000
1929	2,323,000,000
1930	2,031,000,000
1931	1,614,000,000
1932	1,260,000,000
1933	1,263,000,000
1934	
1935	

¹ Compiled from the 1935 *U.S. Department of Agriculture Yearbook*. The preliminary estimate of the value of dairy products for 1935 was \$1,600,000,000.

The Marketing of Dairy Products.—The importance of dairy products as a source of income to the farmer is shown by gross receipts (Table 53).

¹ Poultry and eggs accounted for 9.9 per cent of the annual average total farm income for the period 1924–1930. The income from this source during 1933 amounted to 9.5 per cent of the total annual income. The farmers received, including the value of products consumed on the farm, \$1,230,000,000 from poultry and eggs in 1929; approximately \$603,000,000 in 1932, slightly less than 50 per cent of the 1929 income; and only \$580,000,000 in 1933. The decline in income was due to the fall in prices rather than to a lower physical output. The per capita consumption of eggs for the period 1920–1933 was 25 pounds; for the period 1930–1933 it was 27 pounds. The value of the egg production was \$793,000,000 in 1929, \$373,000,000 in 1932, and \$433,510,000 in 1934.

The producers of dairy products received 16.4 per cent of the annual average farm income for the period 1924-1930. The proportion received in 1933 rose to 20.4 per cent.¹ The producers of this group fared much better during the depression than the producers of other groups of farm products, with the exception of fruits, nuts, and vegetables. The income received from dairy products, however, increased only very slightly from 1932 to 1933. A probable explanation is that, since income derived from the other groups declined relatively much more during the depression, it was only natural that the income from them should rise more rapidly when better times arrived than the income derived from dairy products.² There is no doubt, however, that the returns from grains; cotton; fruits, nuts, and vegetables; and live stock and products other than dairy products, and poultry and eggs were stimulated by the action of the A.A.A. This improvement, however, came largely in the latter half of 1934 and during 1935.

The Demand for Milk.—Milk going directly to the consumer is bought in small quantities; that going to processing plants is purchased in large amounts. It is estimated that 25 cents of each dollar spent for food by the average family goes for dairy products. Milk not only is an excellent food when taken by itself or in one of the many manufactured forms, but it also serves as a supplement to certain other foods by greatly increasing their flavor and nutritive value. The distribution of the demand for milk in the United States, for the years 1924, 1932, and 1933, as indicated in Table 54.

Approximately 25 per cent of the total milk supply is utilized on the farms where it is used for household purposes, to produce farm butter, and to feed calves. Consumers of bottled milk and cream account for about 30 per cent of the total demand for milk.³ Slightly less than 45 per cent of the total demand comes from industry, which utilizes milk as a raw material to produce butter, cheese, evaporated milk, ice cream,

¹ "The farmers in the North Atlantic and New England states alone received as much for their milk, eggs, and chickens in 1933 as all the wheat growers in the country received for their wheat. In the same year the dairy cattle-men of New York State received more for their milk than the hog raisers of Iowa for their hogs. Throughout the depression fruits and vegetables have put more cash in farmers' pockets than all the grains combined or all cotton and cottonseed combined." *Bull. of the National City Bank of New York*, p. 130, September, 1934.

² Dairy products valued at almost \$9,500,000 were imported during the first seven months of 1935.

³ According to estimates by the Bureau of Agricultural Economics, about 42 per cent of the annual consumption of milk equivalents for the period 1924-1929 was in the form of whole milk; about 6 per cent in the form of cheese, and about 52 per cent was in the form of butter and other dairy products selling at about the butter price. F. V. Waugh, principal agricultural economist in charge of Division of Marketing Research.

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TABLE 54.—DISTRIBUTION OF THE DEMAND FOR MILK¹

Source of demand	1924		1932		1933	
	In 1,000,000 lb.	Per cent	In 1,000,000 lb.	Per cent	In 1,000,000 lb.	Per cent
Farm demand.....	26,073	27.90	26,311	25.02	26,239	24.66
Household use.....	11,296	12.09	11,969	11.38	12,222	11.49
Farm butter.....	12,600	13.48	11,536	10.97	11,217	10.54
Fed to calves.....	2,177	2.33	2,806	2.67	2,800	2.63
Non-farm demand:						
Bottled milk and cream....	27,981	29.95	32,093	30.50	31,213	29.32
Manufactured products in milk equivalents.....	38,708	41.43	46,632	44.33	48,877	45.91
Creamery butter.....	28,578	30.59	35,577	33.81	37,016	34.77
Cheese (factory).....	4,179	4.47	4,841	4.60	5,437	5.11
Evaporated milk.....	2,677	2.87	3,534	3.36	3,863	3.63
Ice cream (factory).....	2,497	2.67	2,126	2.02	2,048	1.92
Condensed milk.....	714	0.76	463	0.45	409	0.38
Dry whole milk.....	63	0.07	91	0.09	104	0.10
Exports.....	671	0.72	160	0.15	119	0.11

¹ Compiled from *Some Facts about Evaporated Milk and Other Dairy Products*, published by The Evaporated Milk Association, 1935.

condensed milk, and dry whole milk. An insignificant proportion is exported.¹ The farm demand, apparently, is declining in relative importance. The proportion used to meet the bottle demand has remained fairly constant since 1924, while the proportion taken by industry is increasing. Dairy products comprised about 24.6 per cent of the nation's retail food bill in 1929; meat and lard, about 18.9 per cent; fresh fruits and vegetables, 7.5 per cent; and poultry and eggs, 6.2 per cent.²

The annual per capita consumption of milk and cream in cities and villages declined from 40.8 gallons in 1929 to 38.8 gallons in 1933. There was a considerable variation, however, from geographical section to

¹ The major uses for milk and the amount consumed in each use in 1933 is as follows: milk and cream consumed as such in cities and villages, 14,517,880,000 quarts; evaporated milk, 1,544,198,000 pounds; sweetened condensed milk in tins, 53,279,000 pounds; sweetened condensed milk in barrels, 153,663,000 pounds; dry milk, whole and skim 286,183,000 pounds; creamery butter 1,673,235,000 pounds; farm butter 549,535,000 pounds; cheese 567,467,000 pounds; casein, 24,087,000 pounds; factory ice cream, 148,913,000 gallons; ice cream mix, 108,067,000 pounds; plain condensed milk, 214,189,000 pounds; condensed buttermilk, 50,175,000 pounds; dry buttermilk, 53,260,000 pounds; dry cream, 184,000 pounds; concentrated skim milk (for animal feed), 17,217,000 pounds; malted milk, 12,430,000 pounds; and milk sugar, 4,645,000 pounds. Quoted from *Some Facts about Evaporated Milk and Other Dairy Products*.

² According to estimates by *New Era in Food Distribution*.

section. Thus the annual per capita consumption in the North Atlantic states was 42.9 gallons; in the South Atlantic Central, 28.7 gallons; in the South Central, 29.7 gallons; in the North Central, 40.6 gallons; and in the Western section, 40.1 gallons. The annual per capita consumption of butter was 17.29 pounds in 1929, it rose to 18.14 pounds in 1932, then declined to 17.69 pounds in 1933. The per capita consumption of ice cream was 3 gallons in 1929 but only 1.70 gallons in 1933.

The demand for fluid milk on the part of the consumer is fairly constant and inelastic. The housewife wants the milk fresh, clean, sweet, and delivered daily. The average monthly consumption of milk is, perhaps, slightly higher from April to October than in the other months of the year, and the demand for buttermilk in New York is reported to reach the maximum in July and August. Unemployment in the large industrial centers tends to reduce the consumption of dairy products. The demand for butter, cheese, canned milk, and ice cream controls the demand for the fluid milk used in production. The greatly increased demand for these manufactured products has helped to reduce the seasonal element¹ in the demand for milk and at the same time has aided in preventing the surplus problem from being worse than it is.

The demand for milk and milk products is practically universal and is both small and large scale. Approximately 98.2 per cent of the families of Milwaukee, for example, use milk.² The amount of milk consumed per family bears a direct relation to the income enjoyed. Thus it was found that the *A* and *B* families,³ which comprised 22.46 per cent of the total number of families studied, bought 26.82 per cent of the milk consumed by the entire group. The *C*, *D*, and *E* families, comprising 77.54 per cent of the total number, bought 73.18 per cent of the volume. The average weekly purchases for the five classes of families were 10.7 quarts. The average weekly purchases of the *A* group were 13.13 quarts; of the *B* group, 12.52 quarts; and of the *D* group, 9.4 quarts. The *E* group, however, purchased 10.6 quarts weekly. The higher weekly purchases of the last group is explained by the fact that this group had a large number of children. In answer to the question, "What would cause you to use more milk?" only 7.2 per cent said, "A lower price." Twenty-seven and nine-tenths per cent said nothing would cause them to buy more; 16.2 per cent said if they did more baking; while 14.27 per cent said if they had more children they would buy more milk.⁴

* ¹ The consumption of ice cream during winter has been so greatly increased since 1925 that the seasonal element has been materially modified.

* ² Based on a study of milk consumption in Milwaukee, supervised by the author.

* ³ The *A* families were those living in homes with rental values of \$62 and more a month; the *B* families, \$50 to \$61; *C*, \$40 to \$49; *D*, \$30 to \$39; and the *E*, under \$30.

* ⁴ The *Milwaukee Journal's* study, published in *Consumer Analysis*, showed that the average family monthly consumption of milk was 40.1 quarts in 1926 and 49.3

The Supply Factors.—The total output of milk from cows on farms, except the amount wasted and used for calf feed, reached an all-time peak in 1933—about 102,333,000,000 pounds.¹ The total volume of butterfat probably exceeded 4,000,000,000 pounds. The Bureau of Agricultural Economics estimates that the farmer sold, during the period 1924–1929, about 48 per cent of his production as whole milk and about 52 per cent as butterfat. On the average, 100 pounds of milk produces about 3.93 pounds of butterfat. Thus the average 100 pounds of milk was sold as 48 pounds of whole milk and 2.04 pounds of butterfat.² Considerably less than half the total milk supply can be sold for immediate consumption as bottled milk and cream. The price paid the farmer for his milk is limited by the price that can be secured from the consumer for the bottled milk and for the various milk products. When there is a surplus of milk in a given market, the farmer may receive much more for that portion of his milk sold for bottling purposes than he does for that used for manufacturing.

Milk Prices.—The average price received by the dairy farmer has varied from \$1.29 a hundred pounds in 1933 to \$3.42 in 1920. The bulk of the milk output in Wisconsin, one of the leading dairy states, is used in manufacturing. The farmers received on the average, in 1932, the following prices per hundred pounds for their milk according to the different uses: 81 cents when used to make cheese; 83 cents when used to make butter; 92 cents when used for condensed milk; and \$1.28 a hundred pounds when used in liquid form for household purposes. The highest price received for milk used for cheese making was \$2.77 in 1919; the highest price received for milk used for butter was \$2.53 in 1920; the highest received from condenseries was \$3.16 in 1919; the highest price received for milk to be used as liquid milk was \$3.46 in 1919. Prices received in 1935 were \$1.27, \$1.23, \$1.35, and \$1.55 for the respective uses.³

Multiple Prices.—The farmer may be paid a flat rate for all milk produced: a certain price for an assigned quota and a lower price based on the price of butter for any amount in excess of the quota; and a price based on the use of the milk. Thus if milk is used for household purposes the highest price is paid; a lower price is allowed for that amount used for creamery purposes, and a still lower price for any amount used for

quarts in 1933. The average family annual consumption of packaged butter in 1928 was 114.4 pounds; in 1930 it was only 84.4 pounds, but in 1933 the consumption rose to 94.4 pounds. The lower consumption in 1930 and 1933 was, no doubt, a reflection of decreased consumer purchasing power.

¹ There were 21,455,000 milk cows two years old and older in the country on Jan. 1, 1920; 22,505,000 in 1925; 22,910,000 in 1930; 26,062,000 on Jan. 1, 1934; and 25,100,000 on Jan. 1, 1935.

² WAUGH, *op. cit.*, p. 6.

³ *Wisconsin Crop and Livestock Reporter*, January, 1936.

other manufactured products. The more he can sell for household use, the higher will be his money return. The milk supply that cannot be sold to the ultimate consumer must be disposed of in the industrial market. The prices the manufacturers receive for the manufactured dairy products will not permit, after the addition of the costs of manufacturing and marketing, the payment to the farmer of as high a price as he receives for the milk used for bottling purposes. Since it requires, for example, 10 to 11 quarts of milk to produce 1 pound of 92-score butter, the milk alone required to produce the pound of butter would cost $52\frac{1}{2}$ cents if the milk sold for 5 cents a quart. When butter sells for 30 to 35 cents a pound, the price of commercial milk must necessarily be low. The production of butter in 1933 was 1,745,335,028 pounds—an increase of 5.4 per cent over 1931—with a dollar value of \$357,513,355—a decrease of 18.9 per cent from the 1931 value. Thus a larger supply brought the farmer a lower money return. The volume of production of cheese in 1933 was 1.6 per cent above that of 1931, but the value was 16.4 per cent below that of 1931.

Characteristics of the Supply Factors.—Milk for human consumption is taken from goats, mares, camels, reindeer, buffalo, and the well-known dairy cow. This discussion is confined to the marketing of cows' milk. Fluid milk is quite bulky, a gallon weighing approximately 8 pounds. The outstanding characteristics of milk are perishability and fluidity. Milk must be consumed or manufactured within a short time after it is taken from the cow. It cannot be stored economically in the raw state for any appreciable length of time. The time element may be extended somewhat by means of refrigeration and pasteurization and by observing certain sanitary precautions. The liquid quality of milk presents difficult problems in transportation and storage. Metal cans and especially built tank cars and trucks have been developed to meet this situation. These peculiarities of the product have tended to concentrate the dairy industry around the large industrial centers. Although fresh milk has been transported from Wisconsin to Florida, this is only feasible under exceptional conditions. The major portion of the whole milk supply of a typical large city is usually drawn from a radius of 300 miles and less. Milk distributors of the United States deliver daily approximately 40,000,000 bottles of milk and collect the empty bottles. "The cost of delivering a bottle of milk weighing nearly 40 ounces and collecting the empty bottles is less than the 3-cent stamp put on a letter weighing one ounce or less."¹

Grades of Milk.—The quality of milk is judged chiefly by testing it with the Babcock tester. Some breeds of cattle produce higher test

¹ From a radio address delivered in 1935 by the president of National Dairy Company.

milk than others. The Holstein, for instance, is noted for its quantity production and rather low butterfat test, which averages 3 to 3.9 per cent; the Guernsey's test, on the other hand, runs from 3.8 to 4.9 per cent and even higher; the Jersey probably produces the highest test milk of the group, but the quantity produced is likely to be less. The majority of cities now require that all milk sold within their limits have a butterfat content of at least 3.5 per cent and meet a definite standard with reference to bacterial content; and some demand that the herds from which the milk is drawn be tested for tuberculosis. Milk as received by the consumer is separated into three grades. "Certified" milk, which must be produced and sold under careful supervision, is used primarily as food for infants. Grades A and B are pasteurized, but Grade A has a lower bacterial content than Grade B. The health departments of some cities send out inspectors to enforce standards of cleanliness with reference to the care of the animals, the milking utensils, and the milk. The typical city health department exercises great precaution to protect this source of food supply.

Conditions of Production.—Milk is produced under small-scale methods. Dairy cows are found scattered throughout the United States. There is a decided concentration of the industry, because of the characteristics of the product and of the demand, around the large cities. Minnesota, Iowa, Wisconsin, New York, Pennsylvania, Michigan, and Ohio are important milk-producing states. Minnesota, Iowa, and Wisconsin produce almost 50 per cent of all the butter of the United States. Michigan, Ohio, Indiana, and Nebraska are other important butter-producing states. Dairying has become a highly specialized industry in these highly concentrated areas. The farmers invest large sums of money in herds, buildings, and equipment. In such instances, fairly large-scale methods are applied. This industry, however, is apparently not suited to really large-scale methods because of the necessity for the personal supervision of an owner.

The dairy industry has developed rapidly in the United States during the last half century. The growth to the present large proportions is due to a number of factors. The rapid increase in our urban population and the emphasis placed by the medical profession upon the food value of milk and other dairy products have brought about increased consumption. A number of discoveries and inventions likewise have tended to increase demand, which stimulated production. A few of the more important ones are refrigeration, the milk tank car and truck, the Babcock tester, the cream separator, pasteurization, large-scale creameries, and ice cream plants. Increased knowledge of breeding and feeding dairy animals has increased the production of butterfat and milk per cow.

It takes an increase of about 1 per cent in the number of cows each year to keep milk production in balance with the increasing demand. During the period 1929-1933, however, the number of milk cows increased faster than the demand, with the result that production and consumption were thrown out of balance. This forced the farmers to take lower prices for their dairy products.

The volume of milk produced each year bears a close relation to the hay crop and the condition of the pastures. A large hay crop and good pasturage are reflected in a large flow of milk. Low prices discourage milk production to some extent. Farmers allow the calves to take more milk, and the old and less profitable cows are sold when milk prices are unsatisfactory. High prices for dairy products, on the other hand, tend to encourage expansion not only in the dairy belt but also in other sections where, for the moment, milk production may be more profitable than grains, live stock, or vegetables. Milk production can be reduced much faster than it can be increased. The farmer can rapidly reduce his herd through sale to the butcher; to increase it, however, requires four or more years. The production of milk in any given district varies with the season and weather conditions. The drought of 1934, for example, greatly reduced the flow of milk in the affected areas and raised the price of feed in all sections. The production of milk for the country as a whole was about 4 per cent less in 1934 than in 1933; the number of cows was 4 to 5 per cent less than the previous year. The production is less during late autumn and winter than in the spring and early summer. Cows produce less milk on sub-zero days than during pleasant weather. One cheese factory in Wisconsin reports that its receipts of milk amounted to 150,000 pounds of milk daily during July and August and only 60,000 pounds during the severe months of winter. Since the household demand is about the same throughout the year, the production capacity during the winter must be great enough to meet the fluid-milk requirements. This leads to a large surplus during April, May, June, July, and August. This surplus is utilized by manufacturing it into cheese and butter and by canning it. Milk in these forms can be stored during the period of surplus production for use during the season of light production.

The price of milk is determined largely by factors existing in the local consuming market. Thus the price of a quart of standard 3.5 per cent milk delivered to the housewife in Milwaukee was 11 cents at the time the consumer in Los Angeles was paying 16 cents. The price received by the producer fluctuates from month to month as well as from year to year. Thus during the period 1921-1934, inclusive, the highest price of the year was received by the Wisconsin farmers in January four times, in December four times, and in November, February, March, and July,

one time each during the twelve-year period. The average price received during 1932 was the lowest received since pre-war days.

The markets in which a producer may sell fluid milk depend upon the distance to be traveled, the transportation facilities, and the freight rates. During March, 1930; the Northwestern and the Soo railroads extended from 75 to 90 miles the zone in which milk rates to the Chicago market were reduced. Waukesha, Lake Geneva, and Salem, Wis., important concentration points, were given the benefit of a lower rate, thus increasing materially the potential milk supply of Chicago. The reduction in rates to Chicago, for instance, varied from 6 to 21 cents per hundred pounds, on carload lots of 40,000 pounds. Milk trucks are constantly increasing their proportion of the total volume transported.

The Producer.—The dairy farmer, in times past, has been a strong individualist. He has been suspicious of the urban consumer, the dealer, and the cheese and butter manufacturers. One cheese maker remarked that in dealing with a farmer one must never allow him to know that one is making any money. If the farmer should find out that the cheese maker's earnings are greater than his own, according to this man, he will become jealous and haul his milk to another factory. He has a tendency to continue along in the customary way until disaster overtakes him, and then he is loud in his criticism of the distributors.

There is evidence that a large number of dairy farmers have awakened to the necessity of studying the character and trend of the demand for their products and of exercising some control over the production and marketing of them. The development of the cooperative dairy association has done much to lead the individual dairyman to lay aside his petty grievances, associate more with the alert and progressive element, recognize the benefits of education and the scientific study of economic conditions, methods of production, and marketing. He has discovered by experience the value of collective bargaining in determining the price of milk. He has learned that he cannot be unreasonable, that he cannot exercise, successfully, monopoly control over dairy products, yet he can secure through proper management an equitable return on his investment and effort.

The more progressive dairy farmers have been giving considerable attention to ways and means of reducing production costs. They have, perhaps, been too slow in eliminating non-profitable cows and have not given enough thought to proper feeding. The costs of production may be reduced through proper management. A study of dairy-farm management in Michigan for 1932 and 1933 indicates how wide the variation in costs may be among farmers.¹ The average annual amount of butter-fat produced per cow varied from 180 pounds in the poorest herd to 482

¹ Summary of the report was published in *Hoard's Dairyman*, Nov. 10, 1933.

pounds in the best herd. The average total cost per cow per year varied from \$67.85 to \$188.75. The returns received varied from a loss of \$70.66 to a net profit of \$34.07 per year. The cost per pound of butterfat extended from an average of 23.6 cents for the low-cost producers to an average of 60.1 cents for the highest cost herd. Feed costs ranged from 8.7 to 20.5 cents per pound of butterfat produced.¹ These figures clearly indicate that efficient farm management has an opportunity to reduce appreciably the costs of producing milk, thereby either increasing the profits of the dairy farmer or reducing the costs of dairy products to the consumer or perhaps doing both to the mutual advantage of the producer and the consumer.

Methods of Selling.—The farmer may sell his milk and butter directly to the consumer; or he may sell the cream and milk directly to the creamery, cheese factory, and condenseries;² or he may market his product indirectly, through independent dealers who pasteurize, bottle, and deliver it to the home, hotel, restaurant, hospital, school, and retail trade; or he may join a cooperative association and market his milk through this form of agency.

Services Performed and the Agencies That Perform Them.—The large number of small producers, the perishability and fluidity of the product, and the desire on the part of the consumer to have fresh and sweet milk and cream delivered daily necessitate the performance of special services which are quite costly.

The delivery of milk by the farmer to the consumer is confined chiefly to the smaller towns. It was found in Milwaukee, for instance, that 92.88 per cent of the milk consumed in the homes was bought from dairy dealers who deliver the products to the home; 6.56 per cent is bought from stores. Less than 1 per cent of the total consumed is purchased directly from the farmer. The reason given for buying from the dairy companies by 67.28 per cent of the consumers who so bought was "convenience."³ City ordinances which require that fluid milk be pasteurized make direct marketing by the individual farmer impracticable. The small-scale producer could not afford the large overhead cost required. It is more economical to have the milk supply delivered to the consumer

¹ This study includes all the costs involved in producing the milk. "The farmer has received going wages for all labor spent on cows. He has received interest on all money invested. The cow has paid all taxes and every other cost properly chargeable to the enterprise. The farmer has also received market price for all crops grown on the farm which he merely sells to the cow instead of to the elevator or other market. The cow has paid market prices for feed, labor, bedding, and all other items—and this in a market substantially higher because of the demand created by the cow herself. Certain products of the farm would have no market if it were not for the cow." Editorial comment, *Hoard's Dairymen*, *ibid*.

² The processing plants may be either independent or cooperative organizations.

³ *Milk and Cream Survey of Milwaukee County*, *op. cit*.

by a large dealer or distributing company which, because of its large-scale operation, can establish milk routes, make deliveries and collections, erect pasteurization plants, receive shipment from farmers, and even establish concentration points in the country where the farmers deliver the milk. The company brings the milk from these points in large tank trucks if the distance is not more than 50 or 60 miles, and in specially constructed tank railway cars if the distance is too great for economical truck transportation. Cincinnati, Atlanta, and Indianapolis, for instance, receive the major portion of their milk supply delivered in trucks. Chicago in 1928 received 55 per cent of its milk supply in tank cars, 20 per cent in tank trucks, 17 per cent in cans hauled in trucks, and 7.5 per cent in bottles and cans delivered by railroads.¹

The large distributing companies, instead of buying directly from the individual farmer, may buy from a cooperative organization. This seems to be more satisfactory for all concerned. The distributor has a more dependable milk supply, and the cooperative frequently sees to it that the primary collecting function is performed and enforces standards of quality, cleanliness, and quantity. The cooperative is in a stronger bargaining position than the individual producer and is more likely to secure a satisfactory price. The cooperative may sell the entire fluid-milk output to the distributor or only a certain definitely contracted amount, the surplus being taken by the cooperative cheese factory or other processing plant.² Some cooperatives collect, test, pasteurize, cool, grade, bottle, and deliver milk to the consumer. Such wide activities, however, are usually confined to the smaller cities.

The agencies necessary to market milk efficiently vary in different parts of the country. In the highly developed dairy centers, such as Wisconsin, Minnesota, and Iowa, the farmers usually make direct deliveries to the local creameries, cheese factories, and concentration points. In some of the western states where dairying is on a smaller scale and the producers are much more widely scattered, it has been found more economical to establish large-scale centralizers which draw their raw materials from wide areas. This necessitates an organization of cream stations throughout the country to collect, grade, and ship the cream to the centralizer and to pay the farmer for his product. A centralizer may have two hundred to three hundred of these cream stations collecting and shipping cream to it.

The Cost of Marketing Dairy Products.—Much criticism has come from both the consumer and the producer about the cost of marketing

¹ *University of Illinois, Agricultural Experiment Station, Bull. 318.*

² During the 1932-1933 season, 2,293 associations with membership of 724,000 did an estimated business of \$390,000,000. *U.S. Department of Agriculture, Yearbook 1934.*

milk. It is pointed out that the farmer receives from 2 to 4 cents a pound for the milk while the consumer has to pay 5 to 7 cents a pound. The services necessary to place a bottle of sweet, pasteurized milk at the consumer's back door every morning are expensive. Table 55 shows how the money paid for a bottle of milk by the New York consumer was distributed among the various interested factors.

TABLE 55.—DISTRIBUTION OF CONSUMER'S MONEY PER BOTTLE OF MILK, GRADE B, NEW YORK CITY¹

Year	Price at country plant, cents	Freight, cents	Dealers' margin, cents	Retail price, cents
1922	6.3	1.1	7.3	14.7
1923	6.3	1.1	7.3	14.7
1924	6.0	1.1	7.3	14.4
1925	6.0	1.1	7.4	14.5

¹ "Survey of Milk Marketing in New York," *Milk Plant Monthly*, July, 1927.

It is evident that the relationship between the amount received by the producer and the price paid by the consumer remains fairly constant. Whether the dealer's margin and the amount paid for freight are too much we cannot, of course, determine without a careful study of all factors involved.

Table 56 indicates the distribution of the consumer's dollar spent for milk in Chicago, St. Louis, Peoria, and Quincy during the period 1924-1927. There is, it will be noted, a considerable variation in the percentage received by the farmer.

TABLE 56.—THE DISTRIBUTION OF THE CONSUMER'S MILK DOLLAR¹

Where the dollar went	Chicago	St. Louis	Peoria	Quincy	Average
Retail price.....	\$100.00	\$100.00	\$100.00	\$100.00	\$100.00
Paid farmer.....	45.70	51.40	65.90	69.20	46.90
Purchasing and processing.....	15.20	10.80	16.30	12.30	14.90
Selling and delivering.....	32.10	29.90	9.90	12.60	31.20
General and administrative expense...	3.50	2.80	6.20	3.20	3.60
Dealers' profit.....	3.50	5.10	1.70	2.80	3.40

¹ *University of Illinois, Agricultural Experiment Station, Bull. 318.*

* It appears that the larger the city in which the milk is sold, the less the farmer receives. This seems to be due largely to the high selling and delivery expense incurred in the large cities.

The report of the Bureau of Agricultural Economics, previously referred to, indicates that the margin between what the farmer receives

and what the consumer pays¹ for all milk equivalents seems to increase during periods of low retail prices and to fall during periods of high retail prices; i.e., the farmer tends to get a larger percentage of the retail prices when these prices are rising. Thus the margin in 1920 was 47 per cent of the retail price; in 1921 it rose to 50.6 per cent; in 1924 it was 51.7 per cent; in 1928 it was 50.8 per cent; in 1931 it increased to 60.4 per cent; and in 1932 it reached the peak of 66.0 per cent. The average for 1934 fell to 61.7 per cent. The average for February, 1935, was 54.4 per cent, compared with 63.5 and 68.1 per cent in February of 1934 and 1933, respectively.² The explanation for this situation seems to be that the costs of the distributors are relatively fixed and as the retail price falls, owing either to over-production or to decreased purchasing power on the part of the consumers, competition among the producers forces them to accept lower prices in order to dispose of their supplies.

The farmer fares better, as far as the margin is concerned, when his milk is made into butter and cheese. He receives from 60 to 70 per cent of the price paid by the consumer for butter and approximately 50 per cent of that paid for cheese. The explanation for this better showing is that the selling and delivery expense or dealer's margin is not so great for these products. In view of the fact that the farmer usually receives a lower price for the milk used for cheese, he actually secures a greater money return from his fluid-milk sales.

Much complaint has been directed at the retail price of milk. Some consumers and their political champions believe that the distributors exercise monopolistic control of the price paid the farmers and the price charged the consumers. They contend that the distributing companies enjoy exorbitant profits and that their officers receive too high salaries. The charge of monopoly control does not seem to be supported by the facts. It seems more reasonable to contend that retail prices may be too high owing to inefficient farm management, and because there is too much competition among the distributors; and that the farmer receives too low a price because of inefficient management and surplus production. There are too many dairy distributors, for economical operation, in practically every large city in the country. The *Milwaukee Journal* Survey reported twenty-eight dairy distributors operating in the city in 1926 and forty-three in 1933. The milk-consumption survey, supervised by the author, indicated that 76.08 per cent of the milk bought from the dairy distributors in 1934 was supplied by three companies. Two of these companies furnished 64.2 per cent of the amount purchased from distributors. The other dairy companies were operating on a

¹ The margin includes all expenditures for "transportation, processing, marketing, and distribution."

² See also p. 365, Table 60.

very low average volume. This practice tends to increase costs tremendously. The following discussion serves as a case study that shows the various elements that comprise the total marketing costs of distributors operating in a large metropolitan area.

Costs of Marketing Milk.—A large New York milk distributor states that the money paid for milk by the city customer is apportioned to

	Cents
The average price paid per quart to the distributor during the year 1933.....	9.089
The average price paid to the farmer by the distributor for raw milk in the country.....	3.990
Margin from which the distributor pays his own costs.....	5.099

DISPOSITION OF THIS MARGIN

	Cents per Quart
Labor.....	2.371
At country receiving stations	
At pasteurizing and bottling plants	
For delivery and sales	
For laboratory staff—quality control and research	
For veterinarians	
For farm inspectors	
For office workers	
For miscellaneous labor	
Equipment and materials.....	1.556
For building and other equipment, repairs, and wear and tear	
For pasteurizing and bottling machines, repairs, wear and tear	
For vehicles, repairs, and wear and tear	
For horses—replacements	
For horse feed and bedding	
For coal, oil, gasoline, etc.	
For bottles, cases, and cans	
Transportation to city branches by railroad and motor.....	0.855
Advertising.....	0.063
Taxes.....	0.107
Salaries of officers.....	0.020
Total costs.....	4.972
Profits.....	0.127
Total costs and profits.....	5.099

products and services as indicated above.¹ The computations are based on an average sales figure per quart; *i.e.*, the amount paid the farmers is divided by the total number of quarts purchased to secure the average cost per quart bought. The total amount of money received by the company for milk sold in various forms and to different kinds of

¹ From a statement published by the Borden Company in 1934.

customers¹ is divided by the total number of quarts bought, to secure the average selling price per quart.

The margin of 5.099 cents a quart for 1933 was a reduction from the three preceding years. Thus the margin for 1930 was 6.814 cents per quart; for 1931 it was 6.633 cents, and for 1932 it was 6.074 cents. The decrease of $4\frac{1}{2}$ cents from 1930 to 1933 in the price paid by the consumer was divided between the farmer and the distributor as follows. The farmer received 2.8 cents less, and the distributor received 1.7 cents less. During the period the distributor reported that his profit had been reduced from $\frac{1}{2}$ cent a quart to $\frac{1}{8}$ cent.² He was able to reduce his operating costs in the meantime 1.25 cents a quart.

The explanation for the existing margin between the price paid to the farmer and that paid by the consumer is found in the characteristics of the product sold and the conditions under which it is produced and marketed. The following statement summarizes some of the more important factors affecting the cost of marketing milk in the City of New York:³

1. The average distance milk must be shipped (from the farmer to New York City) is over two hundred miles. To reach Philadelphia and Chicago, for instance, milk must be shipped less than one hundred miles on an average. In most smaller communities the average distance is much less.

2. In Metropolitan New York it is necessary to haul milk from the freight station to the pasteurizing plant and then from the pasteurizing plant to the distributing branch. In most other markets the farmer delivers his milk to the pasteurizing plant (thus avoiding receiving stations and freight costs); it is then taken by route wagons from the distributing branches to customers.

3. A large portion of the milk for Metropolitan New York, even though it comes from New York State farmers, arrives at New Jersey terminals and must be ferried across the river. There is also a lack of industrial zone space for pasteurizing plants on railroad sidings in the City of New York.

4. Labor is more expensive in New York than in other Eastern cities.

5. Congested traffic makes deliveries take longer.

6. Climbing up and down the stairs of apartment houses greatly increases the labor of delivering milk to the "cliff dwellers" of New York.

7. Real estate (plants, branches, garages, stables), taxes, and some forms of insurance are more costly in New York than in other communities.

¹ The milk was sold as fluid milk, cream, buttermilk, cottage cheese, etc., at both wholesale and retail; to families, stores, restaurants, hospitals, schools, and other institutions.

² This firm earned 3.16 per cent profit on its tangible capital during 1933. Its percentage of profit on sales was 1.4 per cent. For the nine months ending Apr. 30, 1934, the company lost on each quart sold. According to a report made by Prof. Leland Spencer, of the New York College of Agriculture, the net profit of 19 city dealers was at the rate of 0.007 cent a quart.

³ *Ibid.*

8. New York City Department of Health regulations are probably the most exacting in the world, and to fulfill them involved added costs not incurred by distributors in other markets.

Variation in Gross Margins.—The Dairy Section of the A.A.A. published a report, as of September 15, 1934, showing the gross operating margins of milk distributors who delivered to homes in fifty metropolitan markets. These margins relate only to that portion of the milk which is sold at retail and delivered to consumers' residences. The margin between the price paid for the raw milk f.o.b. city by the distributor and the price paid by the consumer for the milk delivered at his door varied from 4.41 cents a quart in Chicago to 8.34 cents per quart in Raleigh, N.C. The price paid by the consumer varied from 9 cents a quart in some cities¹ to 15 cents a quart in Miami, Fla. The price paid to the farmer varied from 3.74 cents a quart in Duluth for milk with 3.8 butterfat test to 7.55 cents paid in Washington, D.C., for premium milk with a butterfat test of 4.2. The following table summarizes the results of the A.A.A. study:

TABLE 57.—SPREAD OF GROSS MARGIN PER QUART

	4.4 to 5.0 cents	5.0 to 6.0 cents	6.0 to 7.0 cents	7.27 to 8.34 cents
Number of cities....		26	14	
Variation in price paid for raw milk, cents.....	4.4 = 6.49	3.85 = 7.55	3.74 = 7.66	4.30 = 7.05
Variation in retail price, cents.....	9.0 = 11.0	9.0 = 13.0	10.0 = 14.0	12.0 = 15.0
Variation in butter- fat content, per cent.....	3.5 = 4.0	3.5 = 4.2	3.6 = 4.5	4.0 = 4.5

The consumers in five cities where the spread of the gross margin of the distributors was from 4.4 to 5.0 cents a quart paid prices ranging from 9 cents to 11 cents a quart. The price paid for the raw milk by the distributors ranged from 4.4 to 6.49 cents a quart. The butterfat content of the milk in the same cities ranged from 3.5 to 4.0. The results of this study indicate a direct relationship between the retail price, the gross margin, and the butterfat content of the milk. There is a somewhat less pronounced positive relationship of these factors to the price paid for raw milk. The variations and spreads in gross margins and retail prices indicated above apply only to milk delivered to the homes of the consumers.

¹ The retail price was 9 cents in Evansville, Ind., Indianapolis, and in the Quad cities—Davenport, Iowa, Rock Island, Moline, and East Moline, Ill.

The typical distributor has several gross margins, not only because he pays different prices for his raw milk—these prices determined on the use to which the milk is put—but also because he receives different prices from the various classes of buyers. He usually gets his highest price for bottled milk delivered daily to the family door and probably

TABLE 58.—WHOLESALE AND RETAIL MILK PRICES, APRIL, 1931

City	Dealers' buying prices at city for 3.5 per cent butterfat bulk, cents per quart	Selling price*				Prevailing butterfat test of milk sold, per cent
		On routes			At retail stores, bottles, cents per quart	
		Wholesale trade		Family trade, bottles, cents per quart		
		Bulk, cents per quart	Bottles, cents per quart			
Los Angeles.....	5.27	8.12	10	13	.....	3.6 to 4.2
Denver.....	3.57	7.5	7 to 8	10	8 to 9	3.6
Washington.....	7.01 to 7.48†	10 to 10.75	11.5 to 13	14	11 to 14	4.0
Chicago.....	5.74†	8 to 9.5	12	13	12 to 13	3.5
Indianapolis.....	3.01 to 3.57	6.5	8	10	10	3.8
Des Moines.....	4.94†	7.5	9	11	10 to 11	3.6 to 3.7
New Orleans.....	5.09	8	12	14	14	4.0
Boston.....	5.87†	8.25	9.5	12.5	10	
Detroit.....	5.27†	8.25	9.5	12	10 to 11	3.6
Minneapolis.....	3.98†	7.5 to 7.75	8.5	10	9 to 10	3.5 to 3.6
St. Louis.....	5.48†‡	8.75	10	12	12	3.8
Buffalo.....	5.16†	7.5	9 to 10	12	12	3.6 to 3.75
New York.....	6.24†§	10	14	15	15	3.65
Oklahoma City.....	3.76	7.5	8	10	9	
Philadelphia.....	6.64†	10	11 to 12	12	.....	3.6 to 3.8
Pittsburgh.....	5.76†	.....	.....	12		
Dallas.....	5.59†	8.75	9	12	10	4.0 to 4.2
Seattle.....	3.87†	7	7.5 to 8.5	10 to 11	10 to 11	3.5 to 4.0
Kenosha, Wis.....	6.45	11	11	13	13	3.5 to 3.6
Milwaukee.....	5.37†	7	8.5	10	8 to 10	3.5 to 3.65

* KELLY and CLEMENT, *Market Milk* pp. 428 f.

* These prices represent Grade B milk or the grade which is most commonly sold, the butterfat content varying from 3.5 to 4.5 per cent in different cities.

† Basic prices for fluid milk.

‡ This price applies to part of supply only. Late reports indicate that buying price for part of March supply was 3.87 cents per quart.

§ In the 201- to 210-mile zone.

gets the lowest price and consequently a smaller margin for milk sold in bulk to the wholesale trade. Some bottled milk is sold to the wholesale trade but at a higher price. The following table not only shows the variation in prices in several different cities but also illustrates the variation in gross margins secured on milk sold to different kinds of buyers.

Table 59 gives some later figures, showing the cost to the dealers of a hundred pounds of fluid milk testing 3.7 per cent butterfat content; the price paid by the consumer for the bottled milk delivered to the door daily; and the dealers' margins per quart. The margin covers the dealers' costs of processing, marketing, and collecting and their profits. The price paid for the fluid milk varies widely, it will be noted, from city to city. Thus only \$1.66 per hundred pounds was paid in Des Moines, where the consumer was charged 9 cents per quart, while \$2.11 per hundred pounds was paid in Louisville, Ky., where the consumer was charged 11 cents per quart. The dealers' margins in Des Moines averaged 5.4 cents per quart, and those in Louisville averaged 6.4 cents. The dealers received the highest margin in Cincinnati and the lowest in Milwaukee. The farmers received the lowest prices in the Minneapolis, St. Paul, Des Moines, and Omaha markets and the highest returns in the Louisville, Cleveland, and Detroit markets.

TABLE 59.—DEALERS' COSTS OF MILK, THE RETAIL PRICES, AND THE MARGINS FOR APRIL, 1934*

Cities	Dealers' cost per 100 lb. of fluid milk testing 3.7% butter fat	Retail price per quart, delivered at homes, cents	Difference per quart between dealers' cost and home delivered price, cents ¹
Milwaukee.....	\$1.96	9	4.7
Minneapolis.....	1.66	9	5.4
Kansas City.....	1.83	10	6.0
Cincinnati.....	1.90	11	6.9
St. Paul.....	1.66	9	5.4
Indianapolis.....	1.76	9	5.2
Des Moines.....	1.66	9	5.4
St. Louis.....	1.91	11	6.8
Detroit.....	2.08	10	5.5
Omaha.....	1.66	9	5.4
Cleveland.....	2.07	10	5.5
Louisville.....	2.11	11	6.4
New Orleans.....	1.84	10	6.0

* Quoted from an advertisement by the Gridley Dairy Company, Milwaukee, Wis. This information was said to be based on government figures.

¹ The dealers' average return on all milk sold is considerably below these figures because of wholesale sales to stores, bulk sales to restaurants, county relief sales, etc.

The costs of marketing milk in any given city for a particular distributor are influenced by a number of local factors, such as climatic conditions, health rules and regulations, wage rates, size of city, distances over which the milk must be transported, tax rates, insurance costs, and the volume, diversification, and degree of concentration of business.

Representative cost figures for the dairy industry cannot be presented until we secure figures on the gross margins on all milk sold. We cannot determine whether the gross margin is reasonable or not until we have detailed figures on the operating costs of a large number of distributors located in many different cities.

The Margins on Ten Food Products.—The Bureau of Agricultural Economics attempted to determine the spread between the price received by the farmer and the price paid by the consumer for ten food products.

TABLE 60.—PERCENTAGE OF THE RETAIL PRICE, FOR TEN FOOD PRODUCTS, THAT GOES FOR GROSS MARGIN FOR THE YEARS INDICATED¹

Product	Average percentage by years														
	1910	1915	1919	1920	1921	1924	1929	1930	1931	1932	1933	1934	Feb., 1935		
Eggs.....	33.2	36.4	28.8	29.8	35.0	36.6	34.5	38.8	41.3	41.2	40.9	38.5	33.5		
Potatoes.....	47.2	40.8	37.8	34.9	44.1	46.4	50.6	42.4	47.4	57.5	51.8	50.7	58.1		
Dairy products in milk equivalent ²	48.2	47.8	47.4	47.0	50.6	51.7	51.3	55.6	60.4	66.0	64.9	61.7	54.4		
Hens.....	34.6	37.4	34.8	35.8	41.2	39.6	37.3	42.2		7	48.9	48.6	45.5		
Beef in cattle equivalent.....	35.4	35.6	36.3	45.1	58.	57.9	47.6	53.4	60.0	63.5	63.4	63.1	53.1		
Pork in hog equivalent.....	9.4	26.	15.9	27.1	43.6	42.2	34.6	36.0	4	57	45.9	55.7	41.4		
Excluding processing tax.....												34.1	23.9		
Flour in wheat equivalent.....	36.4	37.0	29.6	36.1	52.8	47.1	52.7	58.7	68.2	71.5	65.0	61.9	58.7		
Excluding processing tax.....												47.6	44.6		
Bread in wheat equivalent.....	74.2	65.1	69.0	81.0	79.6	81.5	85.0	89.5	90.8	86.8	84	82.9			
Excluding processing tax.....												78.2	77.1		
Total average for the group.....	41.9	44.3	39.06	42.	52.6	52.5	49.9	53.3	59.9	65.1	63.2	61.5	54.4		
Excluding processing tax.....												57.3	50.5		

¹ Gross margin comprises the costs of processing, transporting, and marketing. Table compiled from *The Margin between Farm Prices and Retail Prices of Ten Foods*, op. cit.

² Includes whole milk, butter, and cheese.

The margin comprises the cost of transporting, processing, and marketing. The typical family is supposed to consume in a month, according to a study made by the Bureau of Labor Statistics, 14.8 pounds of beef, 12.1 pounds of pork, 2.0 pounds of hens, 5.1 pounds of butter, 1.2 pounds of cheese, 58.8 pounds of potatoes, 21.7 pounds of flour, 32.9 pounds of bread, 5.1 dozen of eggs, and 39.8 quarts of milk. In order to produce these foods in the form in which the consumer buys them from the retailer, 32 pounds of beef cattle, 23 pounds of hogs, 2.22 pounds of hens, 5.1 dozen eggs, 204 pounds of milk, 1.04 bushels of wheat, and 0.98 bushel of potatoes are required. The value of the month's supply of the ten food products was determined by adding the prices received by the farmers for the required amounts of products. The difference between the farm value of these products and the city retail value

of the ten foods represents all the charges between the farmer and the consumer.

These charges include payments for many different kinds of services and are collected by many agencies, including country dealers who buy from farmers and ship to the cities; the railroads and trucks which transport the products; processors, such as meat packers, flour millers, and bakers; many kinds of wholesalers and jobbers, and retail distributors.¹

The reader should bear in mind that the margins quoted in the table *do not* represent the costs of marketing. They include the costs of manufacturing as well, except in the case of eggs and potatoes. The retail price of bread, for instance, includes the costs of other materials in addition to flour as well as the costs of manufacturing, transporting, storing, and marketing. The quantity of the other materials used is indicated by the fact that the 42.6 *pounds* of flour secured from a bushel of wheat produces 62 pounds of bread. No adjustments were made for the value of by-products secured during processing that are not used as food. There are only two products in the group for which the margin represents the "costs of marketing"; those are eggs and potatoes. The processing costs for hens, however, are not large. In the case of hogs and cattle the retail price must reflect the large percentage of loss in weight during slaughter as well as the processing costs. We learned in the preceding chapter that when the weight of the live hog was 228 pounds the dressed weight was 167 pounds—a loss of 61 pounds, or almost 27 per cent. The products of live stock are really joint products. Thus the hog produces lard, bacon, hams, loins, salt pork, and ribs; and fertilizer, hair, and other non-edible products. Each of these sells at a different price. Consequently, the difficulty in arriving at a reliable margin is clearly evident. At most, the figure can be only a rough approximation. The prices at which the packer can afford to sell the edible portions depend to a considerable extent on the prices he can secure for the non-edible parts. The margins may be too high relative to actual costs on some of the edible parts and too low on others. The consumer who confined his purchases to the first would be paying a high price for his meats; the one confining his purchases to the latter would be paying too low a price, while a purchaser of all the different cuts might be paying only a reasonable price. The packer and the meat retailer tend to charge for each cut what the consumer will pay. When the housewives as a group concentrate on pork chops or on hams, the retail prices for these portions are likely to rise while the prices for other portions not in popular favor are likely to decline. Margins on the ten

¹ WAUGH, F. V., *The Margin between Farm Prices and Retail Prices of Ten Foods*, p. 7, 1935.

food products mentioned above, existing prior to the World War, are not strictly comparable to those of more recent years, owing to more processing and to more services furnished by the various functionaries concerned. There have been also shifts in centers of production and of population, and changes in transportation^{*} facilities, marketing organizations, and methods. Many of these conditions have made necessary a wider spread between the price received by the farmer and the price paid by the ultimate consumer.

4. Why did the number of cows on the farms of the country continue to increase until the drought of 1934 even though prices of dairy products were declining?

5. How is the demand for liquid milk, butter, and cheese affected by business conditions in the cities? Is the demand for dairy products elastic? How do you account for the fact that the per capita consumption of butter tended to increase during the depression? Why did it decline during 1935?

6. Why is the per capita consumption of cheese, butter, and milk lower in the United States than in Canada, Denmark, Switzerland, Sweden, Finland, and several other countries? How can the consumption in the United States be increased?

7. What factors enter into the costs of marketing fluid milk? Are the costs too high? Justify your answer.

8. Can you suggest practical ways by which the costs of marketing milk to the ultimate consumer may be reduced?

9. Is there a milk trust? Justify your answer.

10. What is the major marketing problem confronting the dairy farmer?

11. Analyze the figures on margins for the ten food products in Table 60 to determine how the margins vary from year to year. Can you establish any relationship between the size of the margin and (a) the price received by the farmer; (b) the degree of business prosperity or depression? Can you explain why the margins of some products went up when the margins of other products on the list went down during the same period of time, *e.g.*, from 1921 to 1924 the margins for eggs, potatoes, and dairy products went up while those for flour, bread, hens, beef, and pork went down.

12. The figures for 1934 and for February, 1935, show that the processing tax was an important factor in the margin of pork and flour. Does this indicate that the farmers received more or less of the retail price? That the consumer paid a higher or a lower price? That the processor had his operating costs increased by the amount of the difference? Justify your answers.

Assignment

Using the outline on pages 266 and 267 as a guide, prepare a report of approximately 2,500 words on the marketing of one of the following products: wheat, corn, rye, barley, rice, hay, broom corn, hogs, cattle, sheep, horses, mules, eggs, poultry (or chickens, ducks, geese, turkeys), milk, apples, potatoes, citrus fruits, bananas, melons, berries, head lettuce, spinach, peanuts, pecans, grapes, onions, tomatoes, beans, cabbage, tobacco, cotton, wool, flax, raw sugar, raw rubber, green coffee, tea, or any other product you may choose. In each case state definitely the *major* problem met in marketing this particular product, and how it is or may be solved.

1. Problem 2, p. 44. Gratner Company—Selling Milk.

2. Problem 2, p. 165. Land O'Lakes Creameries, Inc.

3. Problem 1, p. 656. New England Milk Producers' Association—Relation of Supply to Price.

CHAPTER XII

THE MARKETING OF NATURAL PRODUCTS

Purpose of this chapter: To analyze the factors that control the forces of demand and supply of natural products; and to discuss the problems met and the methods used in marketing land, mineral products, forest products, and the product of fisheries.

The second major classification of economic goods which we shall consider is the natural products group. This class comprises all those goods that are commonly referred to as "free gifts of nature." Their *basic* utility is supplied by nature. Man then gives them special *form, place, time, and possession* utility by means of his manufacturing and marketing activities. The most important and better known natural products are land, minerals, forest products, and the wild animal life of both land and water.

Characteristic Features of Natural Products.—The distinguishing feature of the members of this class of economic goods is that they cannot be reproduced readily. The supply of agricultural products, for instance, can be readily and conveniently increased or decreased. The ultimate supply of land and of minerals, however, is fixed. The supply can be decreased through use and waste, but man is unable to create new supplies. He may discover new sources of supply and he may develop synthetic substitutes, but he is unable to *create* natural products. The products of forests and fisheries in the original state are produced by the forces of nature without the aid of man. The supplies of these two groups, however, are more amenable to the supervision of man than those of the first two mentioned. Society is able to increase the supplies, to a limited extent, by reforestation and through the propagation of the animal life of the waters. The extent of this practice and the success attained to date have been such minor factors as to be insignificant in effect on the general supply. Governments throughout the world, recognizing this situation, have centered their efforts on conservation of existing supplies rather than on attempts to produce new goods. The extractors and exploiters of natural products, in common with the producers of agricultural and manufactured goods, have encountered marketing difficulties arising from over-production. This situation has been particularly acute among the producers of the minerals.

The natural products, with the exception of land, are used primarily as raw materials by industry. The problems encountered in marketing

natural products are quite different from those met in marketing agricultural products. This is due chiefly to the characteristics of the source of supply, of the product, and of the methods of production. These goods are typically bulky, with the exception of the precious metals and stones. They are usually found long distances from the large centers of consumption; urban land is an exception. Since they cannot be readily reproduced, they constitute what is commonly referred to as a "diminishing asset." This last feature has led society to consider some of these products as being endowed with a high degree of "public interest" which calls for a national policy of "conservation of natural resources."

The discussion in this chapter is confined to an analysis of the problems affecting the marketing of the more important products listed in the following outline.

NATURAL PRODUCTS

- I. Land:
 - 1. Rural.
 - 2. Urban.
- II. Minerals:
 - 1. Metals.
 - a. Ferrous.
 - b. Non-ferrous.
 - c. Precious.
 - 2. Fuels.
 - a. Coal.
 - b. Petroleum.
 - c. Natural gas.
 - 3. Non-metals.
- III. Forest products:
 - 1. Lumber.
 - 2. Pulp wood.
 - 3. Fire wood.
- IV. Animal life of land and water.

The Marketing of Land.—Land originally was a free good, but the growth in population and the desire for the limited number of favorably located portions gave these particular sections an added utility. People who did not own, possess, or control these desirable pieces of land were willing to give the possessors some form of value in exchange for the privileges of ownership.

No product is in more universal use than land; it ranks in importance with air and food. Land may be thought of as not only furnishing a *position* upon which to stand, but also as providing either directly or indirectly, all our water, food, clothing, and shelter. The vast importance of land is suggested by the slogan "Under all, the land." Since the amount of land is definitely limited, the uneven distribution of the

rapidly increasing population tends to develop a greater demand for some parcels of land than for others.

The Demand for Land.—Land is wanted for different purposes. The urban population wants the *position* or *location* feature that land furnishes; the rural population wants this factor plus the additional element of *soil fertility* and a suitable climate for producing crops and supporting live stock. Other interests may want certain lands because of scenic beauty, the forest and mineral products, or the water power that may go with ownership of the land.¹

The demand for land is typically small-scale, while the supply is limited. No more land can be produced to meet the increasing demand. This fact leads to a considerable amount of speculation because of the practice of discounting future values. The demand, moreover, within definite areas may change quite drastically during a period of a few years. A high-class residential district may deteriorate and sell at only a fraction of the former price; on the other hand, a section that has been considered low grade may change rapidly into a highly desirable section owing to some special local development.

The unit of purchase is usually small; the day of selling land by the thousands of acres is rapidly passing. The disappearance of free land in the United States has tended to reduce the size of the unit of sale and to increase the price for the smaller unit. The purchase of a piece of land is normally regarded as an investment by the buyer. He usually forms his decision to buy only after careful consideration. If the land is to be used as a site for a home, the opinions of various members of the family are considered before the contract is signed. A successful and satisfactory purchase demands a considerable amount of knowledge and skill on the part of the buyer. He must be able not only to determine present values but to anticipate future changes that may affect the desirability and therefore the value of the contemplated piece of property.

The effective demand for land was greatly restricted during the period 1930–1934. As purchasing power declined and as available credit disappeared, sales fell almost to zero, and repossession by creditors increased greatly. The tax burden on land tends to increase constantly. The decline in value was much greater during the period mentioned than the decline in taxes; consequently, the tax burden became relatively much greater than formerly. This situation greatly curtails the demand for

¹ The rights that a purchaser receives with reference to water power, mineral deposits, and air when he buys land depend upon the laws of the country in which the land is located. In some countries—those, for instance, whose legal system is influenced by the Napoleonic Code—all mineral deposits are under the control of the government and do not pass with the ownership of the surface of the land as is customary in the United States.

land. A wide spread expectation of monetary inflation tends to stimulate the demand for land.

The Factors That Control Supply.—The supply of land is limited absolutely to the earth's surface; practically, it is limited by the degree of desirability, which, in turn, is determined by such factors as accessibility, fertility, climatic conditions, and the presence of mineral resources, deserts, mountains, lakes, rivers, and swamps. This product is non-perishable to the extent that the number of acres of land remains constant, yet the fertility of the soil may be so reduced through improper methods of cultivation and rotation of crops, and by wind and water erosion, as to make the land practically worthless. The mineral, forest, and fishery products may be extracted to such an extent that nothing valuable remains.

Land, of course, lacks place mobility and it does not possess a high degree of homogeneity. Utilities have to be *transported* to a particular parcel of land since the land cannot be transported to a specified location. Highly desirable property may be found in close proximity to almost worthless land. The value of the property is affected by accessibility to transportation facilities, markets, schools, and other desirable features. While each parcel of land has its own individuality, it is possible to classify the different kinds according to use. The following outline presents a rough classification of this commodity.

CLASSIFICATION OF LAND

I. Rural land:

1. Farm lands.
 - a. Cultivated lands.
 - b. Pasture lands.
 - c. Wood lots and waste lands.
 - d. Cut-over timber lands.
2. Forests.
3. Lakes, rivers, and water-power sites.
4. Mineral lands.
5. National, state, and other parks.
6. Waste lands.

II. Urban land:

1. Commercial and industrial locations.
 - a. Central business section.
 - b. Outlying business sections.
 - c. Manufacturing sections.
2. Residential locations.
 - a. Apartment houses and family hotels.
 - b. Duplexes.
 - c. Single-family dwellings. These locations may be restricted as to type and quality of home that may be erected.
 - d. Suburban property and sub-divisions.
3. Recreational sections—playgrounds and parks.

The federal government adopted the point of view, in 1934-1935, that there was too much land of poor quality in use and developed a policy of buying large acreages of sub-marginal land from individuals for the purpose of retiring them from cultivation. Some of this land is to be sown in grass; other sections are to be made into forest land. If this practice is followed to its ultimate end, the effective supply of farm lands will be reduced by approximately 75,000,000 acres. This is almost 15 per cent of the total amount classified as improved land. This wholesale retirement will have a tendency, over a period of time, to raise the value of the remaining portion. The various governmental units throughout the country, however, are continually adding small quantities to the available supply through irrigation of arid sections and through the drainage of swamps.

Governmental Control of the Use of Land.—The method of utilization of urban property is usually controlled to a considerable extent by the city. Zoning laws divide the city into districts according to the use to which property in each district may be put, *e.g.*, residential, commercial, and industrial districts. The maximum height of buildings that may be erected on the property is fixed by law as well as the percentage of the lot that may be occupied by structures, the size of the courts, side yards, and setback. The maximum number of families allowed in a building may be specified by the city government.

Eminent domain, or the right to take private property for public purposes by paying just compensation, is a recognized power of the federal and state governments. It will be noted from these statements that the marketing of real estate is hedged in with many more legal restrictions than is the case with agricultural products.

Methods of Selling.—The major services necessary for the marketing of land are selling and financing. It is obvious that no transportation and storing of land are involved. Considerable emphasis, however, is sometimes placed upon transporting prospective purchasers to the location of the property. Financing is usually accomplished through the use of first and second mortgages and land contracts. The mortgages are bought by individuals, insurance companies, building and loan associations, land banks, investment houses, and commercial banks.

The sale of land at one time was accompanied with a great amount of formality. The state, as indicated above, continues to exercise control. A formal legal document, the deed, must be executed every time the parcel of land changes ownership. A history of the changes in ownership is kept in the county recorder's office. The owner of a piece of property may sell it outright, passing along all his rights and privileges, or he may sell or lease the "right" to use the property for a limited time or for

certain definitely specified purposes. He may sell directly to the party that intends to utilize the property or he may employ some intermediary. A number of states have laws requiring the dealers in real estate to secure licenses before they can operate.

Real Estate Marketing Functionaries.—Since there is so much legal formality involved in transferring the ownership of a parcel of land, the purchaser and the seller usually find it advisable to employ the services of one or more specialized functionaries. The buyer wants to be sure he is securing a legal title. He may demand an *abstract of title* prepared by an experienced lawyer, tracing the ownership of the property from the earliest record. He may demand a guaranteed title, *i.e.*, a title guarantee company will, for a fee, guarantee that the title is clear and the transference legal.

The principal functionaries are the real estate broker; appraisers; the real estate merchant; the title guarantee company; the law firms which prepare abstracts, contracts, and other legal documents; and the various forms of mortgage companies, *e.g.*, building and loan companies, insurance companies, and banks.

The Broker.—Realtors or real estate brokers are frequently employed to find a buyer for the seller and sometimes to find a seller for the prospective buyer. These brokers may perform merely the true brokerage function of bringing buyer and seller together, but they frequently perform or arrange for the performance of other services, such as tracing the title, financing, appraising, and making out the necessary legal documents. They receive their remuneration in the form of a commission based on the selling price of the property and the amount of service rendered.

The Merchant.—Some real estate firms operate as merchants. They may buy large tracts of land adjoining a city, subdivide it into small parcels, and retail these to people seeking a site for a home. The merchant may buy a single city lot, farm, or industrial property and sell it to an individual buyer. His objective is to make a profit on each transaction. These sales may be for cash, but usually the real estate merchant arranges some plan for financing the transaction. He may extend credit on his own resources or he may form some connection with a local financial institution which extends the credit. Real estate has been sold on the partial-payment plan for a very long time.

Real estate brokers and merchants are well organized. Each city usually has a local real estate board; the local boards frequently are members of the National Association of Real Estate Boards. These associations have done much to reduce the unethical practices of some operators. A code of ethics has been drawn up which all members are asked to endorse and follow.

The Speculator.—Promoters have long been active in the real estate field. Men buy parcels of land upon which to erect buildings, with the expectation of selling the combined properties at a profit. Others buy real estate on a very small down payment, which corresponds to the margin trading of the stock speculator, with the hope of being able to resell to some other buyer within a short time. The marketing of real estate has been notorious for high-pressure selling on the part of some firms and individual salesmen. Telephone and direct-mail solicitation, newspaper advertising, free dinners and transportation, promises of quick and large profits, false statements, and alluring financing plans have been profitably used to entice the gullible. The wild speculation in urban property during the period 1925–1929 was, no doubt, one of the important causes of the financial upheaval during 1929–1932. The ungoverned speculation in agricultural lands during 1918–1920 was a contributing factor in the debacle of 1921.

Marketing of Mineral Products.—The existence of modern civilization depends upon the presence of a bountiful mineral supply. Among the more important mineral products are coal, petroleum, natural gas, iron, copper, tin, lead, stone, bauxite—from which aluminum is derived—Chilean nitrate, sulphur, gold, and silver. All of these products, with the exception of coal and to a limited extent natural gas, are used exclusively as raw material. The demand is fairly inelastic under normal business conditions but it is subject to violent cyclical variations during periods of boom and depression.

Table 61 indicates the relative importance, based on quantity production, of the major products of the principal mineral commodities of the United States for the years given.

The total approximate value of all metallic products for 1932 was \$283,700,000; for 1933 it was \$411,300,000. The total approximate value of all non-metallic products, exclusive of mineral fuels, for 1932 was \$428,400,000; for 1933 it was \$448,700,000. The total value of mineral fuels for 1932 was \$1,743,600,000. The total value for 1933 declined, contrary to the movement of other mineral products, to \$1,628,200,000. The grand total approximate value of all mineral products in 1932 was \$2,461,700,000; in 1933 the grand total was \$2,555,100,000; in 1934 the total was \$3,350,000,000.¹ The increases were due to both increased output and higher prices.

This is the age of power and metal. The minerals, coal, petroleum, and natural gas are the sources of the greater part of the power used daily; the metals are used to facilitate transportation and communication, to manufacture machines, and in the construction of buildings. Since such a large proportion of the minerals is used as raw materials in essential

¹ *Minerals Yearbook*, 1935, *op. cit.*

TABLE 61.—PRODUCTION OF PRINCIPAL MINERAL COMMODITIES IN THE UNITED STATES, 1930 AND 1933, COMPARED WITH AVERAGES FOR 1925-1929*

Commodity	Average, 1925-1929	1930	1933†
Metals:			
Copper, short tons.....	893,000	697,000	225,000
Lead, short tons.....	661,000	574,000	260,000
Zinc, short tons.....	590,000	489,000	306,000
Gold, ounces.....	2,277,000	2,286,000	2,435,000
Silver, ounces.....	61,820,000	50,748,000	22,141,000
Pig iron, long tons.....	37,943,000	29,905,000	14,353,000
Aluminum, short tons.....	88,000	115,000	43,000
Fuels:			
Petroleum, barrels.....	869,000,000	898,000,000	899,000,000
Natural gas, 1,000 cubic feet..	1,487,000,000	1,943,000,000	1,480,000,000
Bituminous coal, short tons..	529,383,000	467,526,000	327,940,000
Anthracite, short tons.....	75,105,000	69,385,000	49,399,000
Nonmetals:			
Sulphur, long tons.....	1,951,000	2,559,000	1,406,000
Portland cement, barrels.....	169,000,000	161,000,000	63,000,000
Lime, short tons.....	4,457,000	3,388,000	2,224,000
Sand and gravel, short tons..	196,849,000	197,052,000	104,000,000
Building stone, cubic feet....	32,365,000	30,169,000	13,584,000
Slate, short tons.....	690,000	464,000	260,000
Gypsum, short tons.....	5,356,000	3,471,000	1,335,000
Crushed stone, short tons....	87,425,000	87,111,000	50,000,000
Salt, short tons.....	7,791,000	8,054,000	7,605,000

* U.S. Department of the Interior, *Minerals Yearbook* 1934.

† Preliminary.

industries, strenuous efforts have been made by nations as well as firms and individuals to secure control of these limited sources of supply. This desire has encouraged among business firms a rather general practice of integration and large-scale production. Large manufacturing firms, such as the U.S. Steel Corporation, own both ore and coal mines; the Anaconda Copper Company owns copper mines, smelters, and manufacturing plants; the Ford Motor Company owns iron and coal mines; the Aluminum Company of America owns bauxite mines and refining and fabricating plants. Some of the large oil refiners¹ own producing lands, lease other properties, control pipe lines, and own tank cars and

¹ The following statement appeared as part of a newspaper advertisement run by the Standard Oil Company (Indiana) on Mar. 20, 1930. "During the year, this company has taken a great stride forward by acquiring control of the Pan American Petroleum and Transport Company and subsidiaries with its five million acres of oil lands, thus providing an assured source of crude petroleum and securing expanded marketing facilities." The same company spent millions of dollars during 1935 in acquiring more producing properties.

ships, as well as wholesale and retail establishments. The marketing problem, as far as the natural product is concerned, does not exist in these cases of integration. The industry, in general, tends to operate under conditions of increasing costs.

Nature of the Supply of Mineral Products.—No one knows the potential supply of mineral resources hidden away under the earth's surface. Many estimates with reference to the amount of the coal and oil reserves, for example, have been made and later found to be too low because of the discovery of new fields. Improved methods of extraction, production, and utilization have had the same effect as an increase in the supply.

Nature of Mineral Products.—The minerals, excepting gas and petroleum, are relatively non-perishable. Owing to the fact that natural products are usually found far away from the consuming centers, and because of their great bulk, weight, and the large quantity of waste material, transportation presents the greatest difficulty. The integrated firms have solved this problem by establishing smelters and refineries near the source of supply and then transporting the refined products to the large central markets or to their own manufacturing plants. The oil and gas industries developed a special form of transportation—the pipe line—to facilitate the concentration of the crude petroleum at the refineries and to transport the gasoline to large distributing points.¹ Coal may be turned into electricity, and then the electricity may be sent over high-tension lines to the point of utilization, within certain territorial limits, much cheaper than the coal can be transported. The limited use of electricity at present prevents the wide application of this plan. The movement of coal from any particular field to any given market depends upon the freight rates and the scale of wages paid the miners. The freight rate alone frequently equals half of the retail price of the product. Whether the Great Lakes industries, for example, buy their coal from the producing regions north of the Ohio River or south of it depends upon the relative freight rates and the wages paid to the miners in these producing districts.

The Non-ferrous Metals.—The non-ferrous metals copper, lead, zinc, and tin have been extracted in such large quantities in recent years that prices during the depression declined below costs of production for many producers. Attempts to raise prices and to maintain them on a high level have not been very effective. High prices invariably stimulate production to such an extent that prices eventually fall drastically.²

The United States produces approximately 50 per cent of the world's supply of copper and consumes about 53 per cent of the world's output.

¹ Tank cars and tank ships are somewhat less specialized transportation equipment.

² For a study of this situation, consult M. T. Copeland, "Raw Material Prices and Business Conditions," *Harvard Business Research Studies*, 2, May, 1933.

An import tax of 4 cents per pound was placed, in 1932, on copper brought into the United States. The domestic consumption of copper was 1,137,000 short tons in 1929. The copper industry in the United States was operating, in the first half of 1935, at around 20 to 25 per cent of its capacity. The demand comes chiefly from the automobile and electrical industries. Under normal business conditions, the public utilities and the building industry use large quantities of copper.

Lead is used for the manufacture of storage batteries, paint pigments, and cable covering. The producers of these products account for approximately 60 per cent of the total demand for lead. There are, of course, many other uses. Lead competes with copper, zinc, and other metals. The prices of substitutes are therefore an important factor of demand. The United States and Mexico are the principal producing countries; still they account for only about 50 per cent of the world production. Canada and India are, however, important sources of supply. The supply is greatly augmented by scrap lead recovered from various products. Lead is found in conjunction with silver and zinc. The producers of this product encountered, during 1929-1934, the familiar problem of over-production and falling prices. They attempted to control prices, with the well-known result; *i.e.*, high prices stimulate production and encourage the use of substitutes. The price in July, 1932, was 62 per cent below the September, 1929, price and 73 per cent under the price of January, 1925.¹

Zinc is used principally in galvanizing and brass making. These activities formerly accounted for 75 per cent of the total demand. Other uses are for rolled zinc, die casting, and the manufacture of certain chemical products. Agreements for control of production have succeeded in reducing production and stocks on hand. Zinc competes with copper, lead, and tin in construction work and with lead in the manufacture of pigments. The demand is affected by general business conditions and by the state of prosperity in the agricultural, building, and automobile industries.

Zinc is found in combination with lead and silver. It is therefore a joint product. The supply and demand for this product are subject to the same kinds of maladjustments as have been mentioned above. The same type of solution has been attempted.

"Tin, unlike lead, zinc, and silver, usually is not found in combination with other metals in ore deposits."² The major sources of supply are Malaysia, Dutch East Indies, and Bolivia. These three regions produce 90 per cent of the world's supply. This supply is supplemented by large quantities of reclaimed tin. The principal demand comes from

¹ *Ibid.*, p. 8.

² *Ibid.*, p. 11.

Europe and the United States. The latter country normally uses 47 per cent of the world supply. Tin is a raw material used to produce tin plate, tin foil, and collapsible tubes; solder and bearing metals; and for weighting silk cloth and in miscellaneous chemicals. The demand for tin is greatly affected by conditions in the canning industry and in the heavy-machinery field.

The sources of tin are highly concentrated, geographically; this condition facilitates effective control of production. The demand is widely scattered throughout the industrial world. The countries that are the major users of tin produce very little. The financial control of copper production is highly centralized, while the use is widespread. Financial interests in the United States control the major sources of supply. This control was used during 1928-1930 to raise prices. The result was that production in Africa, which is under the control of European capital, was greatly stimulated. The new competition, together with the declining demand due to the world-wide business depression, caused a drastic decline in prices, *e.g.*, from 24 cents a pound to less than 5 cents a pound. Tin and copper, in addition to their usefulness in peace-time industries, are necessary for war materials. All nations are, therefore, much concerned about having a sufficient supply for emergencies.

The Precious Metals.—The problems of marketing the precious metals gold and silver are so dominated by political policies and practices that we shall not attempt to discuss them here. The U.S. Government, since 1933-1934, has greatly encouraged the production of these metals by raising the prices to a high level in an attempt to raise the general price level; *i.e.*, the federal treasury has an offer outstanding to buy all gold and silver at prices considerably above the world and national normal prices. Since the major portion of the silver produced in the United States is a joint product, the prices of the other minerals found in combination with silver, and to some extent with gold, influence the amount of the precious metals that can profitably be mined, even though there is a guaranteed high price.

The Fuel Minerals.—None of the mineral products has suffered more from the unbalancing of supply and demand than the fuel groups—coal, petroleum, and natural gas. This group is not related, in either production or use, to the non-ferrous metals.

The production of petroleum increased tremendously from 1922 to 1932. The increase in the United States was almost 100 per cent from 1922 to 1929. During this period we produced from 60 to 70 per cent of the total world output and we consumed 55 to 65 per cent of the world production.¹ The U.S. Geological Survey estimated, in 1919, that the

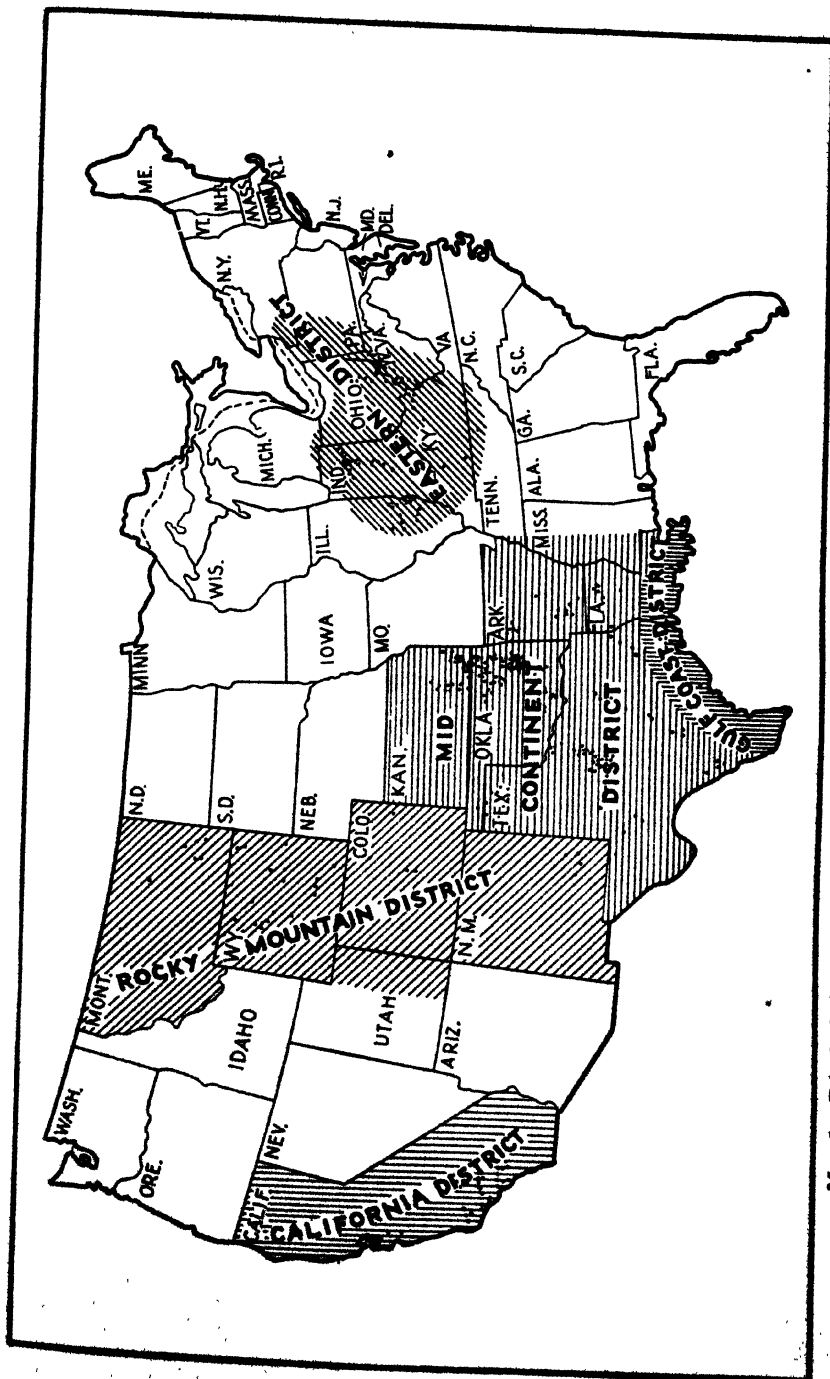
¹ COPELAND, *op. cit.*, p. 16.

United States petroleum reserves amounted to something short of 7,000,000,000 barrels, or less than twenty years' supply at the rate of consumption then existing. New fields were later discovered so that by 1929 the reserves were estimated at three times those of ten years earlier.¹ During the ten-year period more than the 1919 estimated reserves was actually taken from the wells, and the annual consumption had greatly increased. The major producing fields are located hundreds of miles from the principal consuming centers. Since the refineries tend to locate near the centers of consumption, the crude oil must be transported long distances. The major portion is transported by means of pipe lines. The trunk-line tariff on crude oil from the mid-continent to Sugar Creek, Mo., in 1934, was 25 $\frac{3}{4}$ cents a barrel; to Wood River, Ill., 32 $\frac{1}{4}$ cents; and to East Chicago, Ind., 41 cents; from Winkler County, West Texas, the rate to Wood River was 50 cents; and to Whiting, Ind., 60 cents. The field-gathering charge on crude oil in Kansas and Oklahoma was 10 cents a barrel.² The map on page 381 shows the major oil-producing fields in the United States.

Attempts, through governmental action, to control output have been more or less successful. The so-called "hot-oil" problem has been one of the most difficult ones to solve. It was not until the federal and the state governments began determined cooperative action to restrict the flow of oil from the wells, through the pro-rating plan, that effective results were secured. Since petroleum and natural gas are natural resources, endowed with a high degree of public interest, such drastic action seems justified. There has been enormous waste of these products; consequently, society has to take action to protect its future supplies. Crude petroleum is the source of a number of joint products turned out during the refining process. The more important ones are motor fuel of different grades, finished kerosene, heavy fuel oil, finished lubricating oils, wax, raw gasoline, gas oil and paraffin oils, coke, and asphalt. There are, in addition, scores of by-products. The demand for crude oil is, therefore, a derived demand which is quite inelastic. There is a high degree of integration in the industry. A considerable amount of petroleum is produced under small-scale methods by small local drilling companies operating on land leased on a royalty basis from farmers. The farmer is usually paid a small cash rental until a well is drilled. He then receives one-eighth of the oil produced. The crude oil is sold to pipe-line com-

* ¹ H. B. SOYSTER, federal geological expert, estimated in 1934 the total petroleum reserves to be 13,250,000,000 barrels. This is probably a conservative guess. The point we are trying to make, however, is that an accurate estimate is impossible under the conditions now existing.

² *New York Jour. of Commerce*, May 31, 1934. These rates were those charged by the Stanolind Pipe Line Company, a subsidiary of the Standard Oil Company of Indiana. The tariffs were effective as of June 21, 1934.



Map 6.—Principal oil-producing areas of the United States. (American Petroleum Institute, New York.)

panies, which in turn resell to the refiners, or the sale is made directly to the refiner.

Nature of the Demand for Coal.—The distribution of the demand for bituminous coal is estimated to be as follows: 28 per cent consumed by the railroads, 25 per cent by factories, 15 per cent by coke ovens and gas plants, 10 per cent by domestic consumers, 7 per cent by steel plants, 7 per cent by power plants; 4 per cent is exported, 2 per cent used at the mines, and 2 per cent used as fuel for steamships. Anthracite is used extensively for household purposes. Coal is sold for cash and on contract for future delivery. Since 1925 the demand for this fuel has felt the effect of competition from cheap fuel oil, electricity, and, more recently, natural gas.

Some new developments affecting the demand for coal are the recent agitation for the use of water power to generate electrical energy, *e.g.*, Boulder Dam, the Tennessee Valley Authority, and proposals for the St. Lawrence and other places in the country. Owing to the efficient utilization of coal for the production of steam, the railroads effected a fuel saving of almost \$47,000,000 in 1933 compared with 1920. In December, 1920, approximately 197 pounds of coal was required to move each 1,000 gross ton miles of freight; in 1933 only 140 pounds was required to do the same amount of work. This represents a relative reduction in fuel consumption of 28.9 per cent. During the period 1922–1933 the increased efficiency in the use of fuel in railway freight service resulted in a saving of \$440,113,000. This represents a permanent reduction in the demand for coal. The demand from the railroads has been further reduced through electrification and the use of Diesel engines.

Methods of Marketing Coal.—Coal is so widely distributed over the earth that a great amount of it is produced under small-scale methods. The small- and large-scale methods of production and of consumption make necessary two different methods of marketing. Producers typically sell directly to large users and through wholesale and retail coal dealers to the small users. Large-scale producers and large-scale consumers typically use the direct method. Many large users, such as railroads, steel companies, and public utilities, own coal mines. This practice eliminates the marketing process in such instances. Coal brokers and sales agents are also used. This product, in common with other minerals, is bought and sold on the basis of samples and tests. Future trading in crude oil and gasoline on the New York Commodity Exchange was instituted during the first half of 1935.

Chief Justice Hughes, in rendering judgment in the *Appalachian Coal Case* (1933), stated some pertinent facts concerning the supply factors of bituminous coal, *viz.*, "The findings of the District Court, upon abundant

evidence, leave no room for doubt as to the economic condition of the coal industry." That condition, as the District Court states, "has for many years been indeed deplorable." Owing largely to the expansion under the stimulus of the World War, "the bituminous mines of the country have a developed capacity exceeding 700,000,000 tons" to meet a demand "of less than 500,000,000 tons."¹

Marketing Natural Gas.—The discovery of many new natural-gas fields and the rapid extension of pipe-line distributing systems make it possible to use this product to meet the ever-increasing demand for a cheap industrial fuel and a convenient, clean, and economical household fuel. Such industrial users as metal-working, ceramic, glass-making, smelting, and petroleum-refining firms constitute a market for natural gas in wholesale quantities. The household market uses the product for cooking, heating the house, firing the water heater, and operating the refrigerator.²

Demand Factors.—The demand for natural gas is fairly constant. Less is used in winter for household purposes, but the industrial demand during the summer is likely to offset this deficiency. The industrial demand is subject to the cyclical conditions that affect the demand for the products of the particular industry concerned.

Natural gas was used at the beginning of 1930 in more than 2,500 communities having a population in excess of 17,000,000. Some of the larger cities using natural gas are Buffalo, Chicago, Cleveland, Pittsburgh, Wheeling, Cincinnati, Columbus, Toledo, Kansas City, Tulsa, Oklahoma City, Dallas, Wichita, Houston, San Antonio, Baton Rouge, Shreveport, Memphis, New Orleans, St. Louis, Los Angeles, San Francisco, and Denver.³ There was produced in 1933 approximately 1,480,000,000 cubic feet of natural gas with a value of about \$375,000,000 at the point of consumption. The output was about 5 per cent less than in 1932. This decline, however, was much less than for 1931 and for 1932 from the preceding years. The peak was attained in 1930, when almost 1,950,000,000 cubic feet was produced.⁴ The number of natural-gas customers was estimated at 5.4 millions on July 31, 1934. There were in November, 1934, 5,273,500 domestic users of natural gas—a new peak. Revenue for the first ten months of 1934 was in excess of \$255,000,000.

The Competitive Situation.—The chief problem in the marketing of this natural product is to provide the facilities for satisfying the growing demand and to deliver it in such an economical manner that the competition from other forms of fuel, such as manufactured gas, coal, and oil, can be met. Competition from electricity is growing in some sections of the country where subsidized hydroelectric energy is being supplied at a low price. Much attention has been given to teaching consumers how to obtain greater efficiency from the utilization of the product. Natural gas and manufactured gas can be mixed and used to the advantage of both. The former has greater heating power, while the latter tends to conserve the natural supply.

Supply Factors of Natural Gas.—A prediction was made in 1921 to the effect that the production of natural gas had reached its peak and would rapidly decline. Production in 1921, in fact, declined 137,000,000,000 cubic feet compared with the preceding year. At that time the producing region was confined chiefly to Pennsylvania and West Virginia. The great fields of Texas, Louisiana, Oklahoma, Kansas, and California had not as yet been developed.

The rapidity of the recent increase in production is reflected in the growth of consumption, for natural gas is consumed at about the rate it is produced. The consumption in the United States for 1921 was 662,000,000,000 cubic feet; by 1928 it had increased to 1,567,877,000,000 cubic feet and reached the huge sum of 1,943,421,000,000 cubic feet in 1929. It is estimated that approximately 80 per cent of this amount went to industries. About 70 per cent of the gas is treated so as to produce natural gasoline; carbon-black plants consume approximately 10 per cent of the output. Other important consumers are public utilities, petroleum refineries, and other industrial concerns mentioned above. A large quantity is used for fuel in oil- and gas-field operation. The effect of the business depression was reflected in the decline in consumption in 1934. It was estimated, for example, that only 750,000,000,000 cubic feet was consumed during the first ten months of 1934.

Meeting the Transportation Problems.—The wide use of natural gas is made possible through the utilization of pipe lines. Several lines approximately 1,000 miles in length were in use by 1930. A distributing system comprising 800 miles of gas transmission lines and about 6,000 miles of inter-connected distribution mains was in use on the Pacific Coast in the same year.¹ A total of more than 50,000 miles of natural-gas transmission lines was estimated to be in use in the fall of 1934. It is predicted that the entire country will be crisscrossed with pipe lines conveying natural gas much as it is now traversed by wires for the transmission of electrical energy. These long pipe lines also

¹ STEFFLER, *op. cit.*

provide a huge reservoir for storage. It has been found feasible under certain conditions to store gas in the great reservoirs which remain after a natural-gas field has been exhausted.

The peculiarly volatile nature of the product, its high degree of perishability, and its remote location from the consuming centers make integration and large-scale operation necessary. The construction of the elaborate distributing systems requires huge sums of money. The assurance of an adequate source of supply is essential before a large distributing system can be financed. These factors necessitate large sums of money for the development of wells and the purchase or lease of large tracts of land as well as for the concentration and distribution systems. This situation has promoted the formation of super-gas companies. This form of integration comprises producers, pipe-line companies, and local utilities which distribute the products to industries on a wholesale basis and to the homes on a retail basis.

Increasing the Consumption of Gas.—The distributing companies use space advertising, various forms of publicity, direct mail, personal solicitation, and demonstration to increase the consumption of natural gas. Gas appliances, such as ranges, water heaters, furnaces, and refrigerators, are sold on attractive terms by these local companies for the purpose of increasing the sale of gas.

Marketing Forest Products.—The most important forest products are firewood and logs, which are cut from the trunks of the trees. There are, however, many valuable products manufactured from timber. Among the more commonly known of this group are naval stores, which comprise turpentine, rosin, pitch, and pine tar; raw rubber; pulp wood; shingles; charcoal; and maple syrup and sugar.¹

The Demand Factors.—The demand for forest products is enormous. New uses for wood products are being found continually to replace the former demand that is now being supplied with coal, oil, gas, cement, the metals, and various forms of composition materials.

Wood products are used as raw material on a large scale by industrial plants, and as consumer's goods on a small scale by individuals. The importance of the various markets for lumber is indicated by Table 62.

The steadily increasing price of lumber during the last ninety years reflects the increasing demand and the decreasing supply of forest products. Lumber prices increased approximately 400 per cent between 1840 and 1925, compared with an increase of less than 100 per cent

¹ Approximately 12,504,000 maple trees were tapped in 1935; 3,340,000 gallons of syrup and 1,714,000 pounds of sugar were produced. This production was a substantial increase over the 1934 figures.

TABLE 62.—THE DEMAND FOR WOOD PRODUCTS¹

Use	Per Cent
For fuel.....	38.3
For lumber and saw ties.....	33.3
For fencing material.....	7.3
For hewn ties.....	3.3
For pulpwood.....	2.4
By cooperage industry.....	1.3
For shingles.....	0.8
As distillation wood.....	0.5
As piling and excelsior wood.....	0.3
As vehicle stocks, furniture, etc.....	0.2
For other purposes.....	2.7
Destroyed by fire, insects, diseases, etc.....	9.6

¹ Compiled from *U.S. Department of Agriculture Yearbook*, 1923, p. 1079.

in the general price level.¹ The 1933 production of lumber was almost 14,000,000,000 feet, an increase of 37.5 per cent over 1931; the 1933 production of shingles was 3,663,000 squares, an increase of 38.8 per cent over 1931. About one-third of the 1933 production of lumber was yellow pine. Alabama, Louisiana, Mississippi, and Texas furnished more than one-half of this kind. Douglas fir was the next most important kind of lumber—almost 29 per cent of the total; the major quantity, 97 per cent, came from the states of Washington and Oregon.

Approximately 6,543,574 cords of wood, costing more than \$48,000,000, was manufactured into almost 4,333,000 tons of wood pulp in 1933, with a value of almost \$125,315,000. The corresponding figure for 1929 was 4,862,885 tons, with a value of \$223,178,096. Of the total wood consumption for pulp in 1933, almost two-thirds—4,157,117 cords—comprised domestic spruce, hemlock, and Southern yellow pine; and almost one-half—2,921,906 cords—was reported from Maine, Washington, and Wisconsin. The railroads of the United States paid more than \$42,400,000 in 1933 for forest products.

There is a wide variation among the various nations in the consumption of lumber and firewood. The countries with large supplies of forests use much timber; countries with dense populations and denuded land have a low per capita consumption. Table 63 shows the per capita consumption in the countries indicated.

The major portion of wood products, in the form of lumber, is used in the shipbuilding, railroad, farm-implement, automotive, mining, furniture, and general construction industries. This type of demand is now typically located many miles from the forests. This situation tends to increase prices to the consumer and promote the use of substitute materials.

¹ KILLOUGH and KILLOUGH, *Raw Materials of Industrialism*, p. 151.

TABLE 63.—ANNUAL PER CAPITA CONSUMPTION OF WOOD¹

Country	Amount per Capita, Cubic Feet
Canada.....	285
United States.....	228
Germany.....	27
France.....	26
British Isles.....	15
Italy.....	15
Portugal.....	13
Spain.....	9
China.....	6

¹ *Ibid.*, p. 155, quoted from Zon and Sparhawk, *Forest Resources of the World*, Vol. I, p. 49.

The demand for lumber is somewhat seasonal owing to the seasonal character of the general construction industry. There is a decided cyclical element in the demand. During business depressions the demand for forest products decreases sharply. Consumers do not build homes or buy new furniture when they are not employed; industrial firms do not build ships, railway cars, and manufacturing plants when there is small chance of making a profit.

Some Factors Affecting Demand.—The consumption of lumber does not necessarily respond readily to changes in price. This is because so many factors enter into the determination of demand. If the price of lumber "goes too high," other products, such as metal, cement, and composition materials, may be used. The price may rise materially, however, without reducing the consumption, owing to the fact that the finished product, *i.e.*, a building, ship, car, or what not, contains many other materials so that even though the price of lumber may be very high the increased cost for this material may be only a small fraction of the total cost of the finished product. The demand for lumber, in such instances, is closely related to the demand for the other materials which are jointly used, and depends on the demand for the finished article.

The uncertainty of a dependable supply has caused some firms to secure control of large forest acreage. A number of the larger daily newspapers own thousands of acres of timber lands. The trees are manufactured into wood pulp and then into newsprint. The furniture industry finds it necessary to import fine cabinet woods of high value. Mahogany, for instance, comes from Central America, Mexico, and British West Africa; cedar comes from Cuba, Mexico, and Brazil; briarwood, from France, Italy, and French Africa. Only the more valuable woods can overcome the handicap of high transportation costs.

The Supply Factors.—The federal government, in the early days of the republic, gave out forest lands in vast areas to railroads, educational institutions, state governments, and individuals for the purpose of

promoting settlements. A large portion of the timber resources, as a result, was wasted in a prodigious manner. Timber of fine quality, which would now be worth a fortune, was cut and burned by the early settlers so as to prepare the soil for cultivation. Trees were then a disutility rather than an economic good. As the population increased, as transportation facilities developed, and as industries grew, the demand for forest products soon exceeded the near-by supply.

Since lumber is so bulky, the transportation problem assumes large proportions. Low-grade timber cannot be marketed far from its point of origin because of the cost of transportation. There is nearly 50 per cent loss between the log and the finished lumber. This disadvantage has been overcome, to some extent, by locating the sawmills near the forests or on a stream, which furnishes a cheap means of transportation for the logs. The rough lumber can be transported economically, within limited distances, to finishing plants, such as planing mills and furniture factories, and to wholesale lumber yards.

Forest products, in general, are bulky, non-perishable, and unstandardized. They are of many kinds and qualities. Trees are commonly classed as conifers, or softwoods, and hardwoods. The relationship of the two to each other is about seven to two; i.e., there is about 7,000 feet of softwood produced for each 2,000 feet of hardwood. Among the more important softwoods are pine, fir, cypress, spruce, hemlock, cedar, and redwood, some of the important hardwoods are oak, maple, birch, gum, black walnut, and beech. It is estimated that 95 per cent of the coniferous forests, upon which the world depends largely for its construction material, and 89 per cent of the hardwood forests are distributed throughout the north temperate zone. This area has almost three-fourths of the world's population.

Lumber is graded as to strength and durability and for external appearances. The large lumber trade associations have established definite grades and formulated rules for determining the grade. An inspection system is provided for enforcing the rules.

One-fifth of the earth's surface, or approximately 7,500,000,000 acres, according to reliable estimate, is covered with forests. Much of this vast amount of timber land, however, lies so far from the great consuming centers that the cost of transportation prevents the immediate exploitation of these resources. The woodlands in the older countries have been virtually depleted. Only 5 per cent of the original English forests remains; 80 to 90 per cent of the original forests in France, Spain, Belgium, Italy, and Greece has been utilized. The United States, being a much younger country, still has approximately 60 per cent of its original forests.¹ It is estimated that the world's annual cut of wood

¹ KILLOUGH, *op. cit.*, p. 158.

exceeds the annual growth by about 16,000,000,000 cubic feet, or about 30 per cent of the annual consumption.¹ This rapid depletion of an essential product has led national and state governments to attempt to exercise a certain amount of control over the cutting of timber and to undertake reforestation projects. Private interests are not willing to make the investment necessary because it takes a tree fifty years or more to reach commercial maturity.

Methods of Selling.—The lumber industry normally comprises five major elements: ownership of the forest or standing timber; the logging operation, which fells the trees, saws them into logs, and may deliver them to the mill; the manufacturing process, which transforms the log into boards, heavy timbers, or other commercial forms; wholesaling; and retailing. Through integration all these elements may be brought under the control of a single firm. It is a common practice to integrate the first three elements. A farmer, however, may sell his standing timber direct to a mill or to a logging company, which in turn sells and delivers to a mill; or he may cut the trees into logs and sell them "in the woods" or "delivered" to the mill.

Ownership of timber lands in the United States is highly concentrated. A relatively small number of large firms control the major portion of the privately owned forests. This factor, together with the bulky character of the log, has encouraged integration.

It is estimated that a large portion of the lumber, perhaps a third of the yellow pine, is sold by the producer direct to large consumers, such as railroads, furniture manufacturers, and large-scale contractors. The remainder is sold to wholesalers and to retailers; the larger portion is sold direct to the retailers. A number of the large mills own their own retail outlets. A line-yard company may own and operate as many as a hundred retail yards. The large organizations use traveling salesmen, direct mail solicitation, and magazine and newspaper advertising.

Some Middlemen of the Timber Industry.—The small mills are dependent on middlemen for marketing their lumber and often for financial assistance. There are several types of wholesale organizations, selling agencies, independent wholesalers, brokers, commission men, and catalogue houses. There are wholesalers with yards who perform a storage function and wholesalers without yards. The wholesaler frequently maintains buying offices in the more important producing centers and maintains an office and traveling salesman in the consuming territory. He acts as a seller for the manufacturer and as a buyer for the retail dealer and large consumer. He frequently aids in financing the small mill companies. It is a more or less common practice for the wholesaler to advance 75 to 80 per cent of the cost of the lumber to the

¹ *Ibid.*, p. 162.

mill upon receipt of the invoice. The wholesaler who maintains a yard performs, in addition, the functions of concentration, grading, and storage. This service makes possible delivery upon short notice. This is especially important in the Central West and Atlantic Seaboard because of the large quantity of lumber that comes from the South and from the Pacific Northwest. Since the freight rate on l.c.l. lots of lumber is so much higher than on a carload, shipment in carload lots over long distances is more economical; consequently, the large storage and concentration yards perform a valuable service.

The Place of the Trade Association.—Lumber production and marketing in the United States are controlled to a considerable extent by trade associations organized either on a geographical or on a product basis. These associations collect and publish data on production, shipments, unfilled orders, stock on hand, and prices. The leading lumber associations are National Lumber Manufacturers Association, Northern Hemlock & Hardwood Manufacturers Association, Hardwood Manufacturers Institute, Western Pine Manufacturers Association, and South Carolina Pine Association. Such associations assume a peculiar significance because of the character of the product. They are able to exercise monopolistic control over the movement of forest products to market. The rapid development of wood substitutes and the activity of the Federal Trade Commission tend to prevent them from being able to abuse this power.

Some Illustrations.—The position of the minerals and the forest products in our economic life is summarized in an interesting manner in the following quotation:

The paper consumed in one Sunday edition of any of our larger metropolitan papers strips bare 20 acres of spruce forest—a horrid thought that we cannot quite banish by boasting cheerfully that, for all their achievements in literature, architecture, and exploration, the Elizabethans had nothing to compare with our 24,317,020 motor cars, our 89,019,000 miles of telegraph and telephone wires, our 204,391 miles of railway. It is much to the point to add that they had no corresponding and stupendous consumption of metals, fabrics, rubber, coal, lubricants, and gasoline.

Our American industries with their technique of mass production pour into their furnaces and crushers, their vats and autoclaves, enormous tonnages of raw materials. The statistics of consumption look like astronomical data:

Of pulpwood, 7,645,011 cords to make paper; 1,039,921,589 barrels of crude petroleum for gasoline and lubricants; 3,524,682 wine gallons of ethyl alcohol for the manufacture of rayon; 2,294,183 tons of sulphuric acid to make fertilizers; 6,246,363 tons of salt consumed each year in our chemical industries; 76,758,958 tons of coal coked; and 104,712,586 gallons of vegetable oils in our soaps. These are but a single year's consumption in the United States. The whole world's consumption of metals (one of the few materials for which there are approximately

correct international statistics) has been estimated by Dean Theodore J. Hoover, of Stanford School of Engineering, to exceed a billion tons a year, which reduces to the astonishing figure of 1,000 pounds every 12 months for every man, woman, and child in the world.

The natural products furnish the sources of many substitutes, for example, we have vanillin for vanilla beans; rayon for silk; sodium silicate for dextrin and glue; lacquers for varnish; synthetic for natural camphor; aspirin replacing quinine; phenolphthalein used in place of buchu, cascara, aloes, and a score of other cathartic drugs; ammonia, methanol and acetic acid produced from chemical raw materials by chemical processes.¹

The following quotation, a news item published in the *New York Journal of Commerce*,² describes in an interesting manner a primitive method of marketing certain kinds of forest products found in Brazil.

The Brazilian native who plunges into the deep jungle to gather his dribble of the annual Brazil nut harvest experiences thrills and hardships which chill the spines of more sensitive men.

So does the Aviadore, the native banker-broker who finances the gathering of the crop and who arranges to market it through foreign importers, although the risks which he takes are financial rather than physical. An American broker or banker would experience a severe case of jitters if he found himself suddenly thrust into this strictly Amazon basin business, but the Aviadore shoulders his risk with a careless shrug.

The principal Aviadores are located at the cities of Para and Manaus, respective centers of the Brazilian States of Para and Amazonas. Licensed by the State to act as intermediaries between harvesters and buyers, they are required to report each sale for registration and publication. Direct trade between harvester and buyer was recently abolished by law to prevent further exploitation of natives and to assure that the income which accrues to the States from the sale of this product would have a definite minimum value.

As cash has little or no value in the jungle, the Aviadores have worked out a system of barter satisfactory to both natives and to the landed proprietors and which is handsomely profitable to themselves.

At the start of each nut gathering season, the Aviadores load their river steamers and launches to the gunwales with goods of all kinds and descriptions. Up and down the various rivers and side streams sail the ships of this flotilla, stopping at every trading post, at every riverside native hut and settlement beyond the "leased lands."

The Aviadore must be a shrewd guesser as well as a sharp trader, for at each stop he advances goods on credit against the crop of nuts which the native will deliver several months later when he returns from the castanahals. The chief "chart" he follows to plot probable size and value of the crop is one showing the height of the water in the back country. Height of the water determines the

¹ HAYNES, WILLIAM, *Nation's Business*, pp. 2 f., January, 1935.

² Oct. 18, 1934.

distances which can be covered in the nut search as water offers the only means of transportation.

As many of the gatherers will never return from their journey into the jungle, where death lurks in a hundred different forms, this much of the Aviadore's risk is quite apparent. But the Aviadore dismisses risks of this sort with a shrug. If he has traded well the percentage of profit is heavily in his favor. He is chiefly concerned with a more important factor which, despite his vigilance and that of his employes, may cause him to go broke overnight. There is the ever present boogie of his river steamers being stranded high and fast on dry land. Steamers in this remote part of the world cost money and are not easy to replace. When loaded with merchandise on the out trip or with nuts and other goods returning from the interior the loss multiplies.

Only an old Mississippi River captain can fully appreciate the nature of this risk. There are times when the waters of the Amazon and its hundreds of tributaries rise 40 to 75 feet above their normal levels. This is due to the tremendous rainfall, which has been estimated great enough to cover the 3,000,000 square mile floor of the jungle to an all-over depth of 6 feet.

Frequently this rise is tremendous over night, so that normal channels, banks and bends of the rivers are obliterated. Where once was a stream 50 yards wide the captain finds his vessel afloat on a lake, the shores of which are out of sight. Hence, he steers his 100-ton steamer "across country."

As quickly as the rivers rise, so do they recede, so that the "across country" vessel is frequently marooned on dry land a mile or more back from the river.

Railroad operators in this country, steamship owners, and others engaged in transportation may look with envy upon the Brazilian jungle Aviadore with his "ideal" transportation set-up running two-way pay loads into and out of the jungle. They may be fascinated with the fruits to be reaped from the nut trade as well as from its side line of jaguar hides, snake and alligator skins, egret plumes, parrots, monkeys, and other jungle oddities. But unless they will take the risks which the fatalistic trader accepts with a casualness foreign to Americans—the best course to follow is to stay home, secure within the bounds of business he best knows how to handle.

Marketing Products of Fisheries.—There are relatively few important commercial products of the wild animal life of land and sea that reach the channels of commerce. The two most important ones are raw furs and fish. The rapid development of domestic breeding of fur-bearing animals is changing the classification of fur. It is becoming a farm animal product similar to the way raw rubber was changed from a forest product to an agricultural product. The marketing of fish is used to illustrate the fourth sub-division of natural products.

Demand Factors.—Fish have been an important food product for millions of people throughout the world since before the dawn of history. This food product serves as a substitute for meat, dairy products, and vegetables in some countries where meat is too high priced or where dairy products and vegetables are not available. The search for fish as a

food has been responsible, according to some students,¹ for the development of such early maritime nations as the Phoenicians, Greeks, Norsemen, and English.

The demand for fish has been increasing during recent years, yet the total volume of consumption is less than 3 per cent of the world's consumption of food products. The percentage rises to 10 per cent in Norway and Japan.²

The demand is large-scale on the part of the canning and other processing industries which utilize fish as a raw product, and small-scale when used by the ultimate consumer. The sale of fresh fish, because of the high degree of perishability, was confined until recently largely to the seacoast and lake regions. The development of refrigeration, however, extended the area of the market, while the development of the quick-freezing process is bringing the interior of the country within the market area and thereby greatly increasing the volume of sales. The U.S. Bureau of Fisheries estimates that the consumption of packaged fish increased 350 per cent during the fiscal year 1929 over the preceding year. This fact contributed materially to raising the American catch of fish to more than 3,000,000,000 pounds for the year.

The per capita consumption of fish is increasing. The average consumption for the period 1919-1923 was 15 pounds, while for 1929 the estimated per capita consumption was 23 pounds; the per capita consumption of meat, reported for 1934, was 68 pounds of beef, 11 pounds of veal, 6 pounds of lamb and mutton, and 68 pounds of pork. The average annual per capita consumption of fish was back to 15 pounds in 1934, owing to the abnormally low prices for meat products during the year. The per capita consumption of meat products was about ten times the per capita consumption of fish during 1934. The high prices for meat products during 1935, however, greatly stimulated the demand for fish. Canned fish is bought in the following order: salmon, sardines, tuna, shrimp, clams, crabmeat, and oysters. During the year 1929, 122,000,000 pounds of frozen fish, valued at \$15,000,000, was consumed. This represents an increase in volume of 63 per cent over 1922. In 1934 the freezing plants in the United States and Alaska froze 133,494,000 pounds of fishery products, with a value of \$12,000,000. The production of frozen fish in 1934 exceeded that in 1933 by 39 per cent; that of 1932 by 44 per cent; and that in 1931 by 19 per cent. The average monthly holdings of frozen fish and shellfish in 1934 exceeded 48,000,000 pounds. The states of greatest consumption, in order of volume, are New York; Pennsylvania, Illinois, Ohio, Texas, Massachusetts, Michigan, California, Missouri, and New Jersey.

¹ Tansley, D. K., *Marine Products of Commerce*.

² *Ibid.*, p. 16.

The consumption of sea foods is affected to a considerable extent by religious customs. The sale of fish on Friday, during Lent, and during certain other religious fast and abstinence periods is greater than at other times. Some races and nationalities eat much more fish per capita than others. It appears that the season of heaviest fish consumption occurs when the demand for meat products is least.

Supply Factors.—Sea foods are highly perishable and bulky. Fish, when exposed to warm air, deteriorate rapidly. These two outstanding characteristics of the product control the marketing practice. Perishability is overcome, to some extent, by refrigeration, shipping the live fish in tanks, and canning, drying, smoking, pickling, or otherwise curing them. The handicap of bulk is reduced by canning and by eliminating all waste parts and shipping only the edible portion which has been subjected to the quick-freezing process.

The more commonly used varieties of fish are the cod, haddock, halibut, herring, sardines, mackerel, salmon, tuna, and a large variety of fresh-water fish. The United States and Alaska produced, in 1933, almost \$60,000,000 worth of canned fish, comprising the following varieties: salmon, sardines, tuna and tuna-like fishes, alewives, shad, shad roe, caviar, oysters, clam products, shrimp, crabs, and miscellaneous shellfish. By-products such as shells, scrap, and meal, fish and whale oils, and many miscellaneous by-products had a value of \$12,793,256.

The total catch for 1929 was 3,090,000,000 pounds, having a value of \$116,000,000 for the raw product. The edible portion of this catch is placed at 2,662,000,000 pounds. The United States imported more than 350,000,000 pounds of edible fish and exported 214,000,000 pounds for the year 1929. The total volume available for domestic consumption was approximately 2,798,000,000 pounds. The production of fresh and frozen packaged fish at the 155 primary producing plants in the United States amounted to 73,647,000 pounds, valued at \$8,105,000, in 1934; of this amount haddock led other species, with 36,666,000 pounds, valued at \$1,679,000.¹ The states that furnish the major supplies of fish are, in the order of volume produced: Virginia, Massachusetts, New York, California, Florida, Maine, New Jersey, North Carolina, Louisiana, and Washington.²

The greatest producing areas are found within a few hundred miles of the shores of the oceans. The waters off the Atlantic Coast of North America and Europe annually produce several hundred million dollars' worth of fish. The Pacific Coast of North America and the coasts of

¹ Figures from the Bureau of Fisheries, reported in *Domestic Commerce*, July 10, 1935.

² Armour & Company, *Monthly Letter to Animal Husbandmen*, July, 1931.

Japan are two other important fishing areas. The great salmon fisheries along the Pacific Coast of the United States, Canada, and Alaska are well known. Fishing is an important industry in Alaska, Norway, Denmark, Iceland, Newfoundland, Labrador, Great Britain, France, Spain, Canada, Portugal, and parts of the United States. The fishing industry of England alone distributes more than \$100,000,000 worth of fish annually.¹ The quality of fish, oysters, and clams depends to a considerable extent upon the kind of water in which they live.

The supply of ocean fisheries seems to be adequate to meet the demand, at the present rate of consumption, for an indefinite period. The quantity of fish in certain areas of the Pacific and Atlantic Oceans seems to decrease for a period of two years, but in the third year the numbers seem to be as large as ever. This situation is due to the spawning habits of certain species of fish. There is a marked decrease, however, in the supply of fish in the inland waters. The state and federal governments have taken steps to replenish the diminishing supply of game fish. The Bureau of Fisheries maintains about 80 hatcheries for restocking streams and lakes. It has charge, also, of the fur seals of the Pribilof Islands. When the Bureau took control of this source in 1911 there were 200,000 seals; in 1934 there were 1,300,000, in spite of the fact that 54,000 were killed in 1933. About 80 per cent of the fur seals of the world are in this herd. The fur taken in 1933 was valued at \$873,643.²

Characteristics of the Method of Production.—Fishing is both a small- and a large-scale industry. There are thousands of individual fishermen who operate on a small scale using small boats and simple tackle. There are large-scale operators who own fleets of large, modernly equipped steam schooners and trawlers. The fishing tackle used varies from the homely hook, line, and pole to gill, dip, and purse seines, dragnets, traps, and trawls. A trawl line may have as many as 10,000 to 15,000 hooks attached. The fish are taken aboard and iced so as to keep them in a wholesome condition until they reach port, where they are unloaded, and perhaps cleaned, canned, or frozen, and shipped to distant markets. The fishermen use dredges, tongs, and rakes to gather oysters, clams, and crabs.

Characteristics of the Fisherman.—Fishing is a seasonal business, the operation being carried on from early spring until late autumn. The typical fisherman is a rough, rugged individual who is accustomed to the dangers, hardships, and the ways of the sea. He is a specialist who is versed in the habits of the fish and knows where to find them during certain periods of the season. Commercial fisheries employed 116,000 men in 1932; the value of the output was \$55,000,000. Fifty-

¹ KILGOUR, *op. cit.*, pp. 74 ff.

² BOWEN, W. T., *Alaska Fishery and Fur-seal Industries in 1933*.

seven steam trawlers operate out of Boston, and three out of Halifax. They cost \$150,000 to \$180,000, carry a crew of eighteen to twenty men who pay for their food and fuel (oil and coal), and share fifty-fifty with the owners on the trip. A good trip to the fishing banks off the New England Coast means 100,000 pounds of fish worth perhaps \$3,000. A trawler averages about thirty trips a year.¹ There are, in addition, 10,000,000 anglers throughout the country who fish for sport.²

Methods of Selling.—The small-scale fisherman frequently sells his catch direct to the customer either at his home or in the fish market; or he may peddle his product from door to door. Some of these fishermen find it more convenient to sell to retailers, while others prefer to sell to wholesalers.

Local sales are made to the retailer at the wholesale house at market prices which may be stated over the telephone or by direct contact. Small orders are wrapped in paper, and the larger ones are packed in baskets. Free deliveries are made by the wholesalers to near-by retailers. Some of the wholesale firms have regular routes covered by their trucks each day at regular intervals. Orders are taken by the drivers and are delivered when wanted. Out-of-town shipments are packed in boxes and usually are sold f.o.b. city where packed. Fish must be moved quickly from the water to the consumer because of the high degree of perishability.

The rapidity with which fish spoil and the pervasive character of their odor present some unique and difficult problems of handling during the journey from the water to the consumer. The odor from fish is so penetrating that the wholesaler, the retailer, and the housewife must exercise great care to prevent it from ruining other foods.

There are canners who buy large quantities of fish from a number of fishermen. They frequently agree to take the entire catch for the season. These firms collect the fish, sort, grade, clean, and pack them. Other fish may be cleaned, frozen, and shipped direct to retailers throughout the country. Some of the fish may be held in cold storage for future sale.

Integration has developed to a considerable extent. A few large firms own fishing fleets and packing and freezing plants and make sales direct to the retail stores. These firms spend large sums of money advertising the good qualities of their product. They use magazine, newspaper, and radio advertising extensively. The quick-freezing

¹ *Fortune Magazine*, April, 1935. Boston is the fish capital of the United States. The New England fishing boats brought 221,500,000 pounds to the Boston Fish Pier, the largest in the world, in 1934. Almost 46 per cent of the catch consisted of haddock; the remainder comprised cod, mackerel, flounders, pollack, hake, and eel.

² *Domestic Commerce*, Feb. 28, 1935.

process has made it possible for the retailer to supply the consumer with fresh fish on any day of the week rather than only on the two last days of the week.

The Quick-freezing Process.—The perishable-food business furnishes an excellent example of the revolutionary effect invention may have upon the marketing practice of an industry. The introduction of the quick-freezing method mentioned above met with unexpectedly rapid success. During the first year of the use of this method the sale of prepared fish, packaged and frozen, amounted to many millions of dollars; the meat packers took it up, first cautiously, and later began to use it extensively; the government and private interests are using it in the preparation of fresh fruits and vegetables for the market.

One of the large manufacturers and distributors of food products, after carrying on extensive experiments to determine the effect of the process upon various products and the reaction of the consumer to foods prepared by the method, decided to adopt the plan. The rapid increase in sales and the large amount of repeat business indicated the buyer's favorable attitude. The success of the plan seems to depend to a considerable extent on the quality of the food at the time of freezing, on the stability of the frozen condition, and on the promptness of delivery to the consumer after removal of the product from the refrigerator. The sale of such foods appears to be stimulated by having the product packed in containers that permit the buyer to see it before purchasing.

The following statement by the president of the American Institute of Food Distribution, issued after he had visited the stores experimenting with frozen foods, is an interesting comment on the problems involved.¹

The Springfield cases are pretty definite evidence that the displaying of the product where the public can see it is to be the controlling factor to get consumer acceptance.

There will be little chance to use package effects, labels and trade-mark brands, to do the sort of things that have brought such large profits in cereals, cleansing compounds, and other grocery specialties. . . .

A study of conditions in Springfield cannot give an exact listing which are the more important points, but it is quite obvious that the measure of the progress of this new method depends upon the following:

1. Methods of freezing which still permit staple commodities of each type to be processed in central factories and can hold these products so that they can be efficiently distributed over a long period of time and wide territory without impairment of quality.
2. The ability to do these things at a reasonable cost.
3. An efficient distributing organization that will take these commodities and carry them safely through without impairment of quality or excessive cost until they are satisfactorily consumed.

¹ CONRADY, G. C., quoted in *Commerce and Finance*, p. 323, Apr. 23, 1930.

Each of these problems involves an immense amount of scientific investigation, and the two latter problems call for a coordination of many trades that seems difficult to quickly develop.

My own visit to Springfield convinces me that this evolution will now command a broad trade interest that will make it an active factor in food merchandising at a much earlier date than has seemed possible.

The extensive use of the quick-freezing process since the publication of the statement indicates the fundamental soundness of this method of selling perishable food products. Ice cream is produced by the quick-freezing process and kept cold during transportation with "dry ice." Fresh fruits are quick-frozen and thus preserved for future use without loss of flavor and color. Fish are cleaned, quick-frozen, and packed at the sea coast and then shipped hundreds of miles inland where they supply a ready demand. The quick-freezing process is expensive; consequently the low purchasing power of the masses during the depression slowed down the development and extension in the use of the method. Returning prosperity will probably give it a new impetus.¹

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¹ For an interesting account of the fish industry—production and marketing—consult the two articles in *Fortune Mag.*, April and May, 1935.

6. Is there too much land? Justify your answer.
7. "Purchasers of raw materials differ from buyers of semi-manufactured goods or commodities ready for consumption in several particulars." Enumerate the differences and account for them.
8. "Markets for raw materials are well organized as compared with the markets for manufactured articles." What is meant by the term "well organized"? Why is this? How does this situation affect the marketing process and problems?
9. "Many manufacturers prefer to buy raw materials through middlemen rather than direct from producers." Which ones? Why?
10. "Raw materials as yielded by the earth seldom are uniform in quality. This is equally true of products of the mine, forest, farm, or sea." What marketing problems does this condition present? What solutions are being used?
11. "The essential task in marketing raw material is the meeting of the requirements of the manufacturer for his raw material in such a way as to make it possible to market profitably the product to be made from it." How does this condition affect the marketing problem?
12. How is the market for natural products affected by freight rates? Cite specific examples from your own observation or from your reading.
13. Do you believe that the federal government should closely supervise the exploitation of all mineral products? Control the prices? Monopolize the process of extraction of mineral products? Justify your answers.
14. How do you account for such a high degree of integration in the mineral industry? Fisheries? Forest products?
15. Indicate by diagrams the characteristic marketing methods employed in selling farms, urban property, coal, petroleum, natural gas, silver, copper, logs, lumber, and fishery products.

Assignment

1. Problem 3, p. 47. Grayson Company—Coal Dealer.
2. Problem 2, p. 246. Biscay Fisheries Company.
3. "Distribution Problems in the Oil Industry," I and II.
 - I. *Harvard Business Review*, pp. 389 ff., July, 1931.
 - II. *Harvard Business Review*, pp. 78 ff., October, 1931.
4. "Marketing Problems of Bituminous Coal," *Harvard Business Review*, October, 1932.

CHAPTER XIII

THE MARKETING OF MANUFACTURED PRODUCTS

Purpose of this chapter: to analyze the relative importance of manufactured goods in our economic life; to survey the problems met in marketing this class of goods; and to discuss the methods of marketing industrial and consumer manufactured products.

The *Census of Manufactures* estimated the total value of manufactured goods in 1929 at \$69,960,909,712, an increase of more than 10 per cent over that of 1927. The estimated value for 1931 was \$41,038,-402,307 and for 1933 an amount in excess of \$31,000,000,000. The decline was due, in part, to the drastic fall in prices resulting from the world-wide depression of 1930-1935. The number of manufacturing establishments reported in 1929 was 209,862, and they employed 8,821,-757 wage earners; in 1931 the number of establishments was 174,220, and the number of employees was 6,506,701; the figures for 1933 were 141,769 and 6,055,736, respectively. These figures suggest in a very definite manner the important position held by the manufacturing industry in our economic and social life. The dollar value of the products represents, in the main, the wholesale prices received for the goods. This money was then distributed in payment for raw materials, i.e., for many of the products of the farms, mines, forests, and fisheries; manufactured goods, such as machinery, supplies, equipment, and partly manufactured goods used for further manufacturing; and in the form of wages, rent, interest, taxes, and dividends.

The characteristics of manufactured goods, the producers, the methods of production, and the wants and buying habits of the buyers and users are typically quite different from those of agricultural and natural products. The manufacturer, therefore, usually has to meet and solve marketing problems different from those encountered by the farmer and the exploiter of our natural resources. His major function is to buy the products of the farms, mines, forests, and sea and so change their forms, through the manufacturing process, as to give them a utility that will more adequately meet the needs of the various types of users.

The Characteristics of the Supply.—The farmer, as was noted previously, has only limited control over the quantity and quality of his output—since the forces of nature play such an important part in his

production process, and because there are so many small-scale and widely scattered producers. The exploiters of natural resources are likewise dependent, to a great extent, on the caprices of nature and the rational and irrational acts of man. The manufacturer, on the other hand, has the advantage of being able to control the quality and the quantity of his output. He uses machinery which turns out thousands of units, each of which is, for practical purposes, like the others; he is not subservient to a temperamental weatherman who may, without notice, destroy his product entirely or greatly change the anticipated quantity and quality. The production of a standardized product permits sale by description and sample which tends to lower marketing costs. When manufactured goods are produced on a large scale, the producer can use, economically, such mass selling devices as radio, magazine, and newspaper advertising.

The manufacturer has been troubled, however, with the problem of over-production. When he reduces his output to balance his sales he finds himself loaded down, financially, with over-capacity, *i.e.*, idle plant and heavy overhead costs.

The fact that a large-scale manufacturer has a huge investment in specialized fixed capital, in the form of buildings, machinery, and equipment, places him in a precarious position. He cannot readily readjust his plant to rapid and unexpected changes in demand and methods of production without considerable loss. The large overhead costs that accompany modern industry exert a tremendous pressure upon the management to operate continuously at full capacity. This situation frequently leads to over-production, price cutting, no profits, unethical practices, and bankruptcy.

Successful manufacturing rests upon a knowledge of natural laws on the one hand, and a knowledge of human needs on the other hand. . . . On the basis of such knowledge—and through the application of engineering skill and manufacturing technique—raw materials are transformed into useful products.¹

Manufacturers as a group have been more progressive and aggressive, in their attempts to solve their production and marketing problems, than the agricultural producer and the typical exploiter of natural resources. They have hired experts in the field of production and have spent large sums of money in developing new processes, improved machinery, and better methods. This class of producers frequently resort to integration and mergers in an attempt to solve some of their difficulties. They have tended, moreover, since 1920, to focus the major portion of their efforts on the problems of marketing.

¹HATWAY, F., quoted from "Aerodynamics and Streamlining," *Consumers' Research*, General Motors Corporation.

Classification of Manufactured Goods.—Manufactured goods may be classified, on the basis of use, into merchandise for (1) *resale* and (2) *consumption*. Merchandise for *resale* is offered by (a) merchants and (b) producers of various kinds. This class of merchandise is either sold in the same form as bought by the merchant or added to some other product by the producer and sold in a combination or as an accessory. No material structural change is made in the products under consideration as they move along the route from producer to merchant, fabricator, and final user. The major portion of this group of goods is eventually bought and used by the ultimate consumer. Merchandise is bought for *consumption* by (a) institutions, (b) business concerns, such as merchants, for their own business use—not for resale; manufacturers, for equipment, supplies, materials, and accessories,¹ and (c) ultimate consumers, who typically buy from retail merchants. The reader will, of course, recognize the fact that all goods sold for resale will eventually be bought for consumption. The organization, policy, and procedure followed in marketing any given manufactured product are dynamically influenced by the purpose for which it is purchased. This in turn determines *who* buys it, *i.e.*, individual consumer, manufacturer, institution, exploiter, assembler, or merchant.

Manufactured goods may be classified also on the basis of speed or rate of consumption during use into (1) durable and (2) non-durable goods, *e.g.*, (1) durable goods bought by (a) the ultimate consumer, (b) business enterprises, (c) institutions, and others; (2) non-durable goods bought by (a) the ultimate consumer, (b) business enterprises, (c) institutions, and others.

The difference between durable and non-durable goods is one of degree. Electrical power and many kinds of supplies, for example, are completely consumed when utilized in the manufacturing process, while machines and buildings may be used continuously for years before they have to be replaced by new ones. Food products and domestic fuel are completely consumed when utilized, while houses, furniture, and articles of clothing may be used over and over for a long period of time. Industry thus purchases both durable and non-durable goods as well as produces both kinds. These purchases are made directly from producers and from wholesalers and retailers. The ultimate consumer purchases both kinds of goods, chiefly from retail stores. It has been estimated that about one-fourth of the annual production of non-durable goods is purchased by industry; the three-fourths is bought by

¹ R. L. Wensley divides industrial goods into four groups, *viz.*, (1) production equipment, (2) maintenance goods, (3) raw materials and parts, and (4) goods needed in wholesale distribution, such as locomotives, box cars, trucks, warehouses, mill supply house facilities. Quoted from a digest in *Domestic Commerce*, July 10, 1933.

ultimate consumers. Industry purchases the major output of durable goods, although the consumer buys an appreciable amount in the form of automobiles, houses, household equipment, books, and many articles of the durable type of clothing. According to the 1929 Census, about 55 per cent of all manufactured goods was bought by individuals. This figure is probably too high, owing to the failure to make adjustments for duplication in reporting and for goods bought from retail stores by industrial establishments.¹ Practically all the purchases of durable goods by business firms are in the form of buildings, machines, and other kinds of equipment used for production purposes. This group of manufactured goods is usually called *capital goods*.

The nature of the demand for manufactured goods is, generally speaking, quite different from the demand for the two other groups of products studied. The demand for agricultural and natural products arises from a desire to satisfy a utilitarian want; i.e., the buyer wants food or raw materials. Although a considerable quantity of manufactured goods is used to satisfy utilitarian wants, a large portion is used to satisfy personal whims and fancies even though the basic want is utilitarian.

The demand for durable goods is subject to wide cyclical variations, while that for non-durable goods is comparatively stable. The buyer of durable goods, whether a business enterprise or an individual consumer, can usually postpone the purchase for a considerable period of time if he, for any reason, thinks the present is not an opportune time to buy. Non-durable goods which are currently used for production or for living purposes must be currently replaced. The following data (see Table 64) prepared by the Federal Reserve Board adequately illustrate this statement.

These figures are for production; but since production over a period of time reflects the demand for the given kinds of goods, these data may be interpreted as reflecting the changes in sales. The average for 1923-1925 equals 100. The combined index for June, 1929, was 125 per cent of the 1923-1925 base. The index for July, 1932, fell to 58, which represented a decline of 54 per cent from the 1929 figure; by January, 1935, the combined index had risen to 91, which was still 27 per cent below the 1929 figure. The items listed under the headings *consumer goods* and *industrial goods* illustrate how the relative volume of sales varied according to the *degree of durability* of the goods. The figures reflect, therefore, the *degree of stability* of demand during the period for the various classes of products. Thus the production of food and tobacco products declined only 16 and 17 per cent, respectively, in 1932

¹ According to L. P. Ayres, in *The Chief Cause of This and Other Depressions*, 1935.

TABLE 64.—FEDERAL RESERVE BOARD INDEXES OF PRODUCTION¹
(Adjusted, 100 = 1923-1925)

Commodity	June, 1929	July, 1932		January, 1935	
		Index	Percentage change from June, 1929	Index ²	Percentage ³ change from June, 1929
Combined index.....	125	58	-54	91	-27
Consumer goods:					
Tobacco products.....	138	114	-17	136	- 1
Food products.....	96	81	-16	91	- 5
Rubber tires and tubes..	146	89	-39	115	-21
Anthracite coal.....	84	55	-35	78	-10
Textiles.....	120	69	-42	103	-14
Automobiles.....	153	33	-78	104	-32
Industrial goods:					
Glass, plate.....	151	38	-75	174	+15
Leather and shoes.....	108	77	-29	106	- 2
Petroleum (crude).....	135	104	-23	131	- 3
Paper and printing.....	127	85	-33	100*	-21
Bituminous coal.....	102	46	-55	74	-27
Zinc.....	120	34	-72	71	-41
Silver.....	95	40	-58	50	-47
Iron and steel.....	148	25	-83	79	-47
Lead.....	110	31	-72	50	-55
Cement.....	112	50	-55	42	-63
Lumber.....	94	27	-71	33	-65
Other indexes:					
Petroleum refining ⁴	170	141	-17	151	-11
Shipbuilding ⁵	120	54	-55	27	-78
Iron-ore shipments.....	128	8	-94	14†	-89

¹ From *Domestic Commerce*, May 10, 1935, quoting from a speech prepared by W. L. White, chief of Marketing Research and Service Division, Bureau of Foreign and Domestic Commerce.

² *Survey of Current Business*, April, 1935.

³ Computed.

⁴ The major output of the petroleum refining industry is bought by the individual consumer.

⁵ These products are industrial goods.

* May, 1934.

† November, 1934.

from the 1929 peak and had regained almost all of this loss by January, 1935. There was, therefore, quite a stable demand for these products which are entirely consumed when used.¹ Such durable goods as automobiles, iron and steel, and plate glass, with declines in 1932 of 78, 83, and 75 per cent, respectively, from the 1929 figures, reflect the ability of users to postpone purchases of these goods for a considerable

¹ Food, of course, is a necessity; the demand for tobacco is based on a habit. There was a large increase in the number of women smokers during the period 1924-1934.

period of time. The figures for rubber tires and tubes, refinery products, textiles, and shoes reflect the semi-durable quality of these commodities. The raw-material products, such as the metals, lumber, cement, and bituminous coal, reflect their dependence on the demand for durable capital goods. There had been only a small increase in the production of this class by January of 1935. The big increase in the production of plate glass reflected the demand for safety glass from the automobile industry.

MARKETING INDUSTRIAL GOODS

Manufactured industrial goods comprise all those manufactured products, from bolts, nuts, and lubricating oils to giant machines, which are used for production purposes or are purchased by manufacturers from other producers to attach, as original equipment, to machines purchased by the ultimate consumer. The classification includes also goods purchased by governments, institutions, railroads, public utilities, contractors, and other business enterprises.¹ Agricultural and natural products are, by definition, not included in this classification.

Tires and batteries, for example, when purchased by an automobile manufacturer as original equipment for his product are *industrial goods*; but such articles when purchased by the consumer to replace worn-out units are *consumer goods*. The problems met and the methods used in satisfying the demands of the two different markets are quite distinct.

The Demand for Industrial Goods.—The importance of industrial goods in our economic life is indicated by the volume of production. According to an estimate made by E. R. Dewey,² approximately 62 per cent of goods available for domestic commerce in 1929 was destined for the industrial user; 83.3 per cent of the total volume of exports during that year was sold for industrial use. The figures in Table 65 suggest the demand for some selected industrial goods as stated by two of the *Censuses of Manufactures*. The figures indicate also the extent of the decline in the demand for the products of the various industries during the depression.

The data from the two census years indicate rather emphatically the effect of a severe depression on the sales of durable industrial goods.

The machinery market built up a delayed demand during the depression of \$18,574,000,000.³ Approximately one-half or more of the 1929

¹ It is estimated that a large automobile manufacturer, for example, may buy materials and parts from as many as 9,000 manufacturers. The majority of these 9,000 firms may be buying and selling to each other. Wensley, *op. cit.*

² Assistant to the director, Bureau of Foreign and Domestic Commerce.

³ According to a survey made in 1934 by the Machinery and Allied Products Institute. This institute comprises "58 member trade associations, each of which

industrial plant, according to the estimate, had become obsolete by the close of 1934. The annual production of machinery just prior to the depression averaged \$6,609,500,000. During the depression, the census

TABLE 65.—VOLUME OF INDUSTRIAL DEMAND AS INDICATED BY DOLLAR VOLUME OF PRODUCTION, FOR SELECTED INDUSTRIES

Industry	Value of production	
	1933	1931
Bakers' machinery and equipment.....	\$ 7,333,000	\$10,800,000
Blowers and exhaust and ventilating fans.....	7,000,000	15,300,000
Bottlers' machinery (except dairy).....	9,000,000	5,600,000
Certain types of office machinery.....	24,000,000	28,500,000
Coffee-roasting and grinding machinery.....	7,000,000	9,000,000
Conveying and elevating machinery.....	11,400,000	22,000,000
Cranes, hoists, and derricks.....	5,600,000	18,400,000
Dairy machinery.....	8,300,000	11,300,000
Dredging, excavating, and roadbuilding machinery..	18,600,000	57,200,000
Electrical machinery (generators, motors, and fans).	74,400,000	138,400,000
Elevators and machinery.....	8,700,000	20,000,000
Engines, tractors, waterwheels.....	55,400,000	147,500,000
Laundry machinery (commercial only).....	6,000,000	14,600,000
Machine tools.....	22,800,000	58,700,000
Metal working machinery.....	13,500,000	36,300,000
Locomotives other than electric.....	700,000	13,000,000
Meters, (gas, water, and other liquid).....	8,000,000	14,400,000
Mining machinery.....	8,700,000	12,500,000
Oil-well machinery.....	20,300,000	23,100,000
Textile machinery and parts.....	57,900,000	61,200,000
Transmission machinery.....	9,700,000	15,300,000
Woodworking machinery.....	6,000,000	11,000,000
Pneumatic machinery.....	7,600,000	16,800,000
Printers' machinery.....	13,600,000	32,300,000
Pumps and pumping equipment.....	53,600,000	72,000,000
Scales and balances.....	6,800,000	12,000,000
Shoe machinery.....	8,000,000	9,700,000

figures indicate, annual production averaged only \$2,737,000,000.¹ The reader will recognize, however, that a portion of this decline was due to reduction in prices. The potential demand for machinery, mentioned above, was divided as follows: 39.30 per cent for foundry and machine-shop products; 32.63 per cent for electrical machinery, apparatus, etc.; 6.48 per cent for engines, turbines, tractors, and water wheels;

covers its separate and distinct industry and is representative of at least 85 to 90 per cent of the volume of industry production." Quoted from *Domestic Commerce*.

¹ *Ibid.*

8.94 per cent for agricultural implements; 3.90 per cent for machine tools; and 13.75 per cent for all other machinery. The potential machinery requirements of builders of machinery alone, in the fifty-eight industries, was estimated at \$45,377,402. Machine tools accounted for 68.65 per cent of this total.

The satisfaction of a considerable portion of this delayed demand for durable industrial goods can be and, no doubt, will be postponed for from one to several years. The purchasers of such goods usually buy only when they see a prospect for a profit in the use of the new machinery, buildings, and other industrial goods. The Durable Goods Industries Committee reported, for instance, that the average age of American locomotives is twenty-one years and that 40,000 of them could be scrapped and replaced by more economical, modern engines at an estimated saving to the railroads of more than \$250,000,000 a year. The management, however, must consider, before buying the new equipment, the prospects for future traffic development, freight and passenger rates, automobile and truck competition, new taxes, government regulation and possible government ownership and operation, the availability of credit, and interest rates, since such large units of capital goods are typically bought with borrowed funds.

The demands of industry for various forms of agricultural products which have been partly processed is illustrated by the automobile industry. The Ford Company, which planned to produce 1,000,000 cars and trucks during 1935,¹ estimated that this volume of production would require, in addition to many other products, 69,000,000 pounds of cotton from 433,000 acres of land for upholstery, brake linings, timing gears, and safety glass; 500,000 bushels of corn from 11,280 acres for rubber substitute, butyl alcohol, and solvents; 2,400,000 pounds of linseed oil manufactured from flax which grew on 17,500 acres of land (the linseed oil is used in paints, core oil, soft soap, and glycerine); 2,500,000 gallons of molasses from 12,500 acres of sugar cane used for anti-freeze, shock-absorber fluids, and solvents; 3,200,000 pounds of wool from 800,000 head of sheep to be used in upholstery, floor coverings, anti-rust preparations and lubricants; 1,500,000 square feet of leather made from the hides of 30,000 cattle (cattle also supply raw materials for milk-casein and hide glues, greases, and glycerine); 20,000 hogs required to supply lard for lubricants, oleic acid, and bristles for brushes; 350,000 pounds of mohair from 87,500 goats are required for making pile fabric.²

¹ According to a statement by Edsel Ford published in the daily newspapers, the Ford Company reached the 1,000,000 unit figure during the first nine months of the year.

² From a Ford advertisement.

The Ford Company estimated that the 1,000,000 cars would cost approximately \$415,000,000. The purchases of materials, supplies, equipment, and other products would be made from more than 8,000 firms. Some of the more important items to be purchased and their costs were estimated as follows: bodies, \$100,000,000; steel and non-ferrous metals, \$75,000,000—about two-thirds of this amount is for steel to be bought in the open market; malleable castings, \$6,618,000; grey iron, exclusive of a large quantity produced in the firm's own foundry, \$2,683,000; aluminum, \$6,000,000; copper, \$3,600,000; large sums for lead, tin, and zinc; tires for original equipment, \$22,500,000; for body finishing and upholstery, approximately \$49,000,000; and for glass and paint, \$15,300,000.

The automobile industry consumed in 1933 approximately 35 per cent of the United States production of malleable iron; 40 per cent of the plate glass—more than \$15,000,000 worth; 54 per cent of the leather upholstery; 23.5 per cent of the aluminum; 15.4 per cent of the copper; and 35.4 per cent of the lead.

The railroads of the United States spent \$6,000,000,000 during the period 1923–1929 for additions and betterments, an amount equal to \$50 for every man, woman, and child in the country. During this period 900,000 new freight cars and 15,000 locomotives were put into use. The railroads spent, in 1933, \$180,526,000 for fuel, \$42,442,000 for forest products, almost \$12,000,000 for steel rails, and more than \$17,000,000 for wheels, axles, and tires; in excess of \$30,500,000 for frogs, switches, iron bridges, structural steel and other iron and steel products; \$18,000,000 for metal and metal products; and \$14,000,000 for oil and greases—a grand total, for the year, of almost \$500,000,000.¹

There is a constant shifting in the relative importance of the different sources of demand for durable goods. Thus the construction industry and the railroads accounted for a much smaller percentage of the total demand for finished steel in 1934 than they did in 1929, while the automotive and metal-container industries materially increased their percentages. The deficits suffered by the railroads during 1932–1935 caused them to curtail sharply their purchases of capital goods; the decline in public utility earnings and unfavorable political action caused these large volume buyers of industrial durable goods to reduce their purchases to only a fraction of their 1928–1930 volume. The construction industry reflected the same adverse situation. The increased consumer buying of automobiles during 1934 and 1935 permitted the

¹ The Class I railroads paid out, in addition, \$1,336,526,000 as wages to labor; \$49,803,000 for taxes; and \$242,507,000 for loss, damage, depreciation, and retirements. The total expenses and taxes for 1933 amounted to \$2,621,140,000. *Yearbook of Railroad Information*, 1934 edition.

automotive industry to increase production, and thereby its purchases. The use of metal containers by the Federal Relief Administration, the greater use of canned goods by the consumer, and the practice of the oil and brewing companies of selling a larger proportion of their products in tin cans increased the demand for metal containers of various kinds.

Buying Motives.—The industrial field comprises, as we have noted, an enormous large-scale demand for heavy machinery, accessory equipment, operating supplies, fabricating parts, and materials. Equipment for installations is bought only at infrequent intervals and usually by major executives. Many of these machines are made to order or according to specifications to meet individual industrial needs. Special machinery might be designed, for instance, to develop the water power at Niagara Falls. Since there is only one more comparable waterfall, and that in Africa, the market for such machinery is clearly limited as well as highly specialized. The demand for accessory equipment, operating supplies, fabricating materials, and parts is not so highly specialized and limited. The demand, in general, for industrial goods is inelastic. Such individual goods as mine hoists, electric motors, machine tools, milling machines, and dynamos, for example, are not bought just because the price is low. The user is more interested in the performance of the article and in whether he can sell his own output at a profit.

The determination of what, when, where, and how to purchase, with the exception of major installations, is frequently delegated to minor officials, foremen, and purchasing agents.¹ These are typically much better informed buyers than the average consumer. Many of them are technically trained, specialized, expert buyers.

Among the more important motives that guide industrial buying are the following: to secure lower costs of production, a better finished product, dependability, durability, flexibility, and simplicity;² to reduce industrial hazards, obtain more satisfactory service, and utilize the prestige that may come from using some well-established and favorably known machine, accessory, or other manufactured product.

The demand for this class of goods is influenced by general business conditions, the development of new methods, inventions, and the policy of the management with reference to obsolescence. Competition arising from modern aggressive industrial leadership frequently forces manufacturers to scrap machines long before they are worn out. The desire of "captains of industry" to keep in the forefront of progressive manufacturers and to produce in larger quantities and at lower costs causes

¹ One of the major problems met in selling industrial goods is to determine who or what group of individuals in a given firm actually control the purchase of various types of equipment, supplies, and materials.

² CORPSELAND, *op. cit.*, Chap. VII.

them, for example, to displace small machines with larger machines and labor-tended equipment with automatic.

Some Supply Factors.—Industries may be grouped into two major classes on the basis of the nature of the manufacturing process, as indicated in Table 66.¹

TABLE 66.—CLASSIFICATION OF INDUSTRIES

1. Service industries:
 - a. Mines and quarries.
 - b. Public utilities and transportation companies.
 - c. Power plants.
 - d. New construction (all forms of business and industrial construction).
2. Manufacturing industries:
 - a. Process industries (convert raw materials into finished products).
 - b. Metal-working industries (which change metal into finished products).
 - c. Textile industries.
 - d. Lumber and woodworking industries.
 - e. Miscellaneous.

Each of these industries contributes to the supply of industrial goods and each constitutes part of the demand for these products. Industrial goods are produced under both large- and small-scale methods. The characteristic method, however, is large-scale. These products are non-perishable and quite bulky, yet some machines represent a high degree of concentration in value. Some made-to-order heavy machinery is so large that grave problems of transportation result. Such equipment may require special transportation facilities, be routed a special way so as to avoid narrow tunnels, low bridges, and other hindrances, or the shipment may be timed in such a way as to move over a part of the route on Sunday and holidays when the traffic is light. With the exception of made-to-order products, industrial goods are highly standardized as to quality, size, design, and grade. Such goods are bought largely on the basis of demonstrated superior performance or the reputation of the manufacturer. The producer frequently enjoys a legal monopoly through patent rights or a virtual monopoly because of a secret process or a superior production organization. These conditions make possible the control of the supply of the products affected. There is a tendency for production to concentrate in an area of great manufacturing activity. The availability of skilled workmen, raw materials, financial services, fuel or power resources, and transportation facilities are other factors that may determine the specific location of a plant.

*Methods of Selling.*²—The manufacturer selling to the industrial market usually sells directly, while the manufacturer selling in the con-

¹ Lockwood, R. C., *Industrial Marketing*, p. 4.

² Consult Martin J. Wolf, "The Wholesaler's Place in Industrial Marketing," a paper read before the industrial marketing group of the American Management Association, Mar. 5, 1930. *Industrial Marketing*. Ser. 9.

sumer market typically uses one or more middlemen. There are, of course, exceptions to these generalizations. A firm producing both classes of goods usually finds it advisable to have separate sales organizations to contact each market. It has been found that salesmen who achieve great success in selling to wholesalers and jobbers frequently do not succeed in selling to the buyers in the industrial market and vice versa. The rubber industry, for instance, has separate selling organizations for the mechanical rubber line and the tires; the paint industry follows a similar plan.¹ Approximately 44.8 per cent of total manufactured goods went to the industrial market in 1929, as follows: manufacturers' sales directly to industrial users, almost \$20,000,000,000; manufacturers' sales to manufacturers' sales branches to industrial consumers, \$3,500,000,000; and manufacturers' sales to wholesalers to industrial users, almost \$5,000,000,000.

At least two-thirds of the industrial goods, according to estimate, are sold directly to the firms that use the products. Large installations, specially designed, and complicated machines are sold directly because of the technical knowledge and service involved. The size of the order and the unit price also make direct contact feasible. Fabricating materials and parts, when sold on specification and contract, are sold directly. Industrial goods may be sold directly when the demand is constant because of repeat sales, and when the size of the order and unit price permit.² A considerable volume of industrial goods, however, is sold through various middlemen; among the more important agencies are supply houses, wholesalers and jobbers, manufacturers' agents, and machinery dealers. Small manufacturers of staple industrial goods and manufacturers of all kinds who sell in small quantities to widely scattered users or to small purchasers of limited means usually find it more economical to sell through middlemen.

The manufacturer's agent does not take title to the goods, nor does he have physical possession of them. He makes the sale, sends in the order, and receives his remuneration in the form of a commission. The machinery dealer and mill supply houses, on the other hand, carry stocks, make delivery, keep records, and make collections in addition to performing the sales function. Jobbers carry a wide line of hardware, tools, and small machinery used by various industries.

The industrial market, as contrasted to the consumer market, is easily located, isolated, analyzed, and measured. The products are semi- to highly specialized goods suitable for a relatively easily determinable number of firms. Since these firms can be conveniently located, their potential needs can be measured. The answers to the following

¹ Cf. *Advertising and Selling*, p. 21, Oct. 19, 1927.

² Cf. *COPELAND, op. cit.*, Chap. VI.

THE MARKETING OF MANUFACTURED PRODUCTS

three questions, among others, constitute the first step toward the successful marketing of industrial goods: Where is the market for this particular machine, supply, or part? What are the characteristic features of this particular market? What is the best method of approaching it—who in the industry or firm controls the purchase of this particular product?

Determining Factors in Choosing a Method.¹—Some of the factors that determine whether a firm will sell directly or indirectly are illustrated by the following cases.

Marketing Drilling Machinery.—A manufacturer selling drilling machinery wanted to know what methods to use in selling his product to mines and contractors. After a study he decided to sell directly to the mines and indirectly to the contractors. The reasons in this particular case were as follows:

Sell directly to the mines because:

1. Mining companies usually carry an ample reserve of repair stocks so that the services of the supply firms and dealers are not needed.
2. If distribution is secured through supply firms, the manufacturer will have to furnish missionary salesmen—so there will be no saving in sales expense.
3. Mine superintendents and other officials prefer to deal directly with the manufacturer.
4. The demand is so concentrated, territorially, that each section can be covered profitably by a salesman because of volume sales.

Sell indirectly to contractors because:

1. The potential market is large, customers are widely scattered, they cannot be located easily, the individual sale is small, and contractors do not carry a reserve of repair parts.
2. Dealers are in a position to render services the manufacturer cannot, except at a prohibitive cost.

Marketing Cotton Goods.—The cotton-goods manufacturer, although producing an industrial good, has felt the effect of a severe shift in consumer demand. The following quotation presents some of the essential facts concerning the marketing of a good whose industrial demand reflects very closely changes in consumer demand:

It is a particular trait of the cotton industry that while its managers have always closely supervised their mills and have often shown shrewd knowledge of the cotton market, they seldom have given much thought to the distribution of their product. This has been cared for either by a commission house or by brokers.

¹ Consult E. O. Shreve, "Determining Channels of Distribution," a paper read before the industrial marketing group of the American Management Association, Mar. 5, 1930. *Industrial Marketing Ser. 4.*

The commission house charges a fee varying from $2\frac{1}{2}$ per cent up to 3 per cent, depending on the kind of goods and number of services rendered. It often guarantees the mill's accounts, advises it as to styles, and sometimes participates even in the management of the mill through representation on its board of directors. These commission houses often are very powerful organizations extending their influence to many mills. The broker is merely a clearing house for orders and charges a fee of $\frac{1}{2}$ to 1 per cent.

To be usable for wearing apparel, the gray cloth produced in the mill must first be finished. Consequently, the main customer of the commission house and broker is the converter, who has the cloth finished (bleached, dyed, or printed) according to his pattern by a job finisher. Sometimes the commission house itself performs this function, but the finisher rarely takes title to the goods he processes. The converter sells the finished cloth to the "cutter-up" (garment manufacturer), to the buying syndicate of a group of retailers, to large department and chain stores, or to the traditional wholesaler who in turn sells to the retailer . . .

The complicated channels of distribution have been a contributing cause to the difficulties of the textile industry: the manufacturers have largely remained out of touch with their ultimate market while important changes were manifesting themselves in the consumption of cotton goods.

First of all, style has acquired an importance unknown before in the trade. In the last five or six years a reaction has set in among consumers against the standardized article manufactured on a very large scale. The public is no longer satisfied with the staple product; it wants something distinctive. This has, of course, resulted in a shift in the demand for fabrics, favoring those which lend themselves to style effects. But it has also had the effect of changing the traditional channels of distribution; the tendency toward style has been responsible for the growing importance of the cutter-up. Direct buying by department and chain stores has continued to develop as have buying syndicates. A change of clientele has thus taken place, the importance of which many mills have not been in a position to gage.

Furthermore, the average size of the order has decreased because of style tendencies and instability of cloth prices. This has increased the manufacturer's selling expenses and forced upon him the load of carrying stock in the face of increased style risk.

Several suggestions have been offered to adjust the distribution end of the industry to the new conditions. One of these is direct selling by the mills without using intermediaries. Considering the multiplicity of outlets in the distribution of cloth, it is doubtful whether this is in all cases the proper solution. It is perhaps not so much the selling house which is at fault as the use made of it by the manufacturer. In spite of his connection with a commission house, the manufacturer cannot afford to remain indifferent toward his sales problem.

On the other hand, the advantages of direct selling may prove an added incentive to the merging of mills in order for them to be able to maintain their own national or even international selling organization.¹

¹ GROSSMAN, C. J. R., "The Possibilities of Cotton Manufacturing in Texas," *University of Texas Bull.* 2832, pp. 10 ff., Aug. 22, 1928.

The importance of the cotton-goods industry is indicated by the following figures. The value of the production in 1933 was almost \$875,000,000 compared with \$817,429,509 in 1931. The total for 1933 was made up as follows: woven goods over 12 inches wide, 8,103,717,584 square yards, valued at almost \$653,700,000; cotton yarns made for sale, almost 498,500,000 pounds, worth almost \$131,000,000; cotton thread, 27,255,000 pounds, valued at \$30,371,863; cotton waste for sale, 361,000,000 pounds, valued at \$12,770,000; and other products valued at \$46,800,000.¹

The Use of Salesmen and Advertising.—The sale of a large variety of industrial goods, especially large machinery and complicated accessory equipment, depends upon convincing the possible user that the particular machine will meet his needs. A high type of salesman, usually a technical man, perhaps an engineer with salesmanship ability, is required to demonstrate the superiority of the product. It is necessary, in such instances, that the salesman be able to talk to the manufacturers or their representatives in their own language. He must be able to understand their problems and aid them in finding satisfactory solutions. He must be able to understand specifications that may be given him and sometimes be able to help design and install the equipment. If the product is highly standardized, such as office equipment, small motors, and tools, such technically trained salesmen are not necessary. Some products are sold from samples; others are installed and allowed to remain with the prospective purchaser until he has had an opportunity to determine their value to him under actual operating conditions. The seller employs, in addition to salesmen, magazine and trade-paper advertising, direct-mail solicitation, catalogues, and booklets with pictures and drawings showing the machine or appliance in operation. A number of manufacturers of industrial goods have conducted large general advertising campaigns directed at the consumer. The expectation or hope is that the consumer will demand merchandise made with the machine of the manufacturer, the finished product that carries the manufacturer's product as original equipment,² or the services produced by the manufacturer's product.³

Changes in industrial marketing practice are taking place. There is a decided trend toward specialization in selling. Full-line selling is being displaced by specialty selling. Manufacturers' agents, carrying heavy goods, are limiting their efforts to a few selective specialties;

¹ U.S. Department of Commerce, *Census of Manufacturers, 1933, Cotton Goods*, p. 2, Nov. 3, 1934.

² The advertising of Timken Roller Bearings and of Fisher Bodies are illustrations.

³ The advertising campaign of the American Laundry Machine Companies, directed to the housewife, is an illustration.

the mill supply houses are specializing to some extent. The changed character of the demand is forcing the change; steel, for example, is now compounded to meet the special needs of the manufacturers who use it. The automobile manufacturers, for example, demand special steels and services. The following quotation presents a good account of the changes taking place:

The steel companies met the changed situation by sending out specialty salesmen, metallurgists and other highly trained specialists.

* * *

Their job is not only to show customers how to use steel, but to solve production problems of all sorts for the metal-working industries. They are troubleshooters par excellence.

There is a decided drift toward that type of selling in the industrial world. In the main, manufacturers in this field are finding it necessary to specialize in their marketing methods. Some companies have their specialty representatives devote all their efforts to certain industries, such as the paper industry, the textile industry, the fertilizer industry, etc. Most companies, however, have found this method of traveling too expensive.

* * *

One company meets this situation by placing its regular salesmen in geographical locations. They handle all classes of industry within this territory. These men are able to handle every routine job that comes along. In addition, they are familiar with the type of industry that prevails in the community, such as textile machinery in the Philadelphia area. These geographical men, however, are not qualified to give technical help or engineering advice to their prospects. Neither are they set up to shoot any more than the simple type of trouble. To take care of the occasional demand that exists in all territories for expert help, this company has a squad of roving technicians that cover the country. These men are experts.

* * *

We find this trend toward specialization, even in heavy engineering lines. Here the average representative is more an engineer than he is a salesman. In any event, he is likely to devote himself to the large orders for engineering products that are pending. It often takes these jobs several months to break. In the meantime the regular salesman is inclined to neglect his other customers and the other items in his line. A number of companies are handling this condition by putting out specialty salesmen.

* * *

One of the most pronounced tendencies toward specialization is in the mill supply house business. The industrial wholesaler, like the wholesaler that carries consumer goods, is handicapped by the large number of articles that he must carry. He simply could not do a good job on everything. Specialization is overcoming this difficulty to a certain extent. Specialization in this field is following three trends:

1. Toward the use of specialty salesmen¹ by the mill supply house;
2. Toward limiting the line to a few articles;
3. Toward concentrating on a line that is adapted to the locality.

* * *

Another trend in industrial marketing is found where producers of parts or ingredients are increasing the markets for those elements by manufacturing products in which the part is used. The General Electric Company has for years been assuring itself an ever-expanding outlet for motors by going into the making of things where motors are used. The International Salt Company is pursuing a similar policy in turning out a seasoning for sausage, in which salt is only one ingredient. The seasoning is sold to farmers and others who may produce sausage in quantities.

The Weston Electrical Instrument Corporation has recently been creating a number of new products, primarily because there is a promising field for these instruments, but incidentally to get additional outlets for the famous Photronic Cell, or Electric Eye as it is more popularly known. Some of these new products are the Exposure Meter, which takes the guesswork out of photography, the Foot Candle Meter, which makes it possible to measure the exact volume of light in any spot, smoke control devices, etc. Weston's experience proves that it is possible for a manufacturer, whose products have hundreds of industrial uses, to build new markets by creating articles not made by any of his customers.¹

The demand for industrial goods is in some respects more complex than that for consumer goods, since it is largely a *derived* demand. There must be a possibility for the managers of industrial enterprises to sell, at a profit, the articles or service produced with the aid of the industrial goods before they will buy in large volume. The price of the industrial goods must be in line with the price that can be secured for the goods produced by the capital goods. Since the purchase of many industrial durable goods must be financed on a long-time basis, this type of credit must be available at an equitable interest rate. The lender of this form of credit will not agree to a loan until or unless he believes there is a reasonable probability that the borrower will realize a profit in his business activity. He wants to be assured that he will receive his interest payments regularly and that the principal will be repaid at maturity.

MARKETING CONSUMERS' GOODS²

The ultimate consumer is the source, either directly or indirectly, of the demand for all material goods, services, and property rights. As was noted above, the demand for industrial goods by manufacturers

¹ MURPHY, JOHN ALLEN, "Trends in Industrial Distribution," *Advertising and Selling*, pp. 28 f., Mar. 14, 1935.

² Much of the discussion of Chaps. II, III, V-VIII applies to this topic and should be referred to during the study of this section.

and other producers is dependent on the demand from the ultimate consumer for the various manufactured consumer goods and services. The demand of the consumer, in many instances, is far removed from the primary demand. Thus the primary demand for iron ore is quite remotely removed from the demand of the ultimate consumer for the services of the dentist, who uses some steel instrument in serving his patients. Some of the primary demands, however, may be satisfied in anticipation of ultimate consumer demand which in fact may never materialize.

Each individual consumes from the day of birth until the hour of death. He pays the expenses of governments, through direct or indirect taxation, and supports educational, religious, and philanthropic institutions by paying for their services. The consumer, in the long run, determines the apportionment of capital, labor, and management among the various producing organizations. He pays a satisfactory price for the goods he wants and passes by the goods that do not satisfy his desires. Thus the fortunate firms succeed while the less fortunate are forced out of the race.¹

The term "consumers' goods," however, as used in this chapter, is restricted to those articles of manufactured merchandise that are used directly to satisfy human wants. This class of goods typically reaches the consumer through the widely known over-the-counter retail store, mail-order house, and house-to-house salesman. Consumers' goods may be classified under two different headings, one classification being on the basis of the *use* to which the goods are put, and the other on the basis of the *buying habits* of the consumer.² Each of the classifications includes both durable and non-durable goods. Which classification is better or more appropriate depends upon the purpose of the analysis. A brief discussion of each classification follows.

Classification on the Basis of Use.—The classification of consumers' manufactured goods on the basis of the use to which the buyer puts the merchandise is of value in determining quantity and quality of production and, to a less extent, in determining a suitable method of distribution. Six major groups with several sub-classes are presented in the following classification:

CLASSIFICATION OF CONSUMER GOODS (on basis of use)

- I. Food and kindred products:
 - 1. Groceries and canned goods.
 - 2. Meat, poultry, and fish products.

¹ Cf. P. H. Nystrom, *Economic Principles of Consumption*, Chaps. I, II, for an interesting discussion of this problem.

² Another classification sometimes used comprises so-called *necessities* and *luxuries*.

3. Dairy products.
4. Bakery products.
5. Sugar products.
6. Confectionery products.
7. Coffee, tea, and spices.
8. Beverages.
9. Miscellaneous.

II. Clothing:

1. Textiles.
2. Shoes.
3. Hats and millinery.
4. Ready-made clothing.
 - a. Men's.
 - b. Women's.
 - c. Children's.
5. Furnishings and accessories.
6. Jewelry.
7. Miscellaneous.

III. Shelter:

1. Housing.
2. Home furnishings and equipment.
 - a. Furniture.
 - b. Floor coverings.
 - c. Heaters and refrigerators.
 - d. Kitchen equipment.
 - e. Musical instruments.
 - f. Fuel and light.
 - g. Laundry equipment.
 - h. A large number of miscellaneous articles.

IV. Sundries:

1. Chemical and drug supplies.
2. Books.
3. Works of art.
4. Miscellaneous.

V. Motor equipment and supplies:

1. Automobiles.
2. Batteries.
3. Tires.
4. Gasoline.
5. Oils.
6. Highways and bridges.
7. Accessories.
8. Repairs.

VI. Farm equipment and supplies:

1. Power machinery.
2. Trucks.
3. Cultivating equipment.
4. Vehicles.
5. Dairy and poultry equipment.
6. Harness.
7. Stock foods.
8. Hardware.

9. Silos.
10. Building materials.
11. Fencing.
12. Miscellaneous.

Classification on the Basis of Buying Habits.—An interesting classification of consumers' goods based on the buying habits and patronage motives of the purchaser is given by Professor Copeland.¹ He divides merchandise into *convenience*, *shopping*, and *specialty* goods. This method of analysis is of particular value to the producer in determining his marketing organization. It is of value to the wholesaler and retailer in aiding them to select merchandise with which to stock their stores. The weakness of the method is the lack of stability in the habits of buying and the large number of "border-line" cases—merchandise that might logically fall into more than one classification. The consumer is continually changing the time, place, and manner of his buying. His wishes concerning quantity, quality, and style are subject to change without notice. There are certain habits, however, which seem to remain fairly constant over relatively long periods of time. This classification, obviously, should not be followed blindly but viewed critically.

Convenience goods, according to Dr. Copeland, are those customarily bought at easily accessible stores, and at frequent intervals, as "repeat" purchases. An important characteristic of convenience goods is that they must be sold at a low enough price per unit to promote wide use. Such merchandise is used continually and repeatedly by a large portion of the population. Typical illustrations are laundry soap, bread, crackers, cigarettes, sugar, coffee, tooth paste, shaving soaps, and newspapers. Such goods are regularly sold in grocery, drug, hardware, electrical supply stores and certain departments of department stores and by mail-order houses. Stores whose major sales comprise convenience goods must be located in easily accessible and convenient places. Buyers do not care to travel far or take much time in negotiating the purchase of this class of merchandise. The manufacturer who sells convenience goods does not want exclusive agencies as distributors; he wants his merchandise offered for sale in as many outlets as he can economically serve. Much of it is distributed through wholesalers to retailers to consumers.

Shopping goods are those for which the consumer desires to compare prices, qualities, and styles, usually in several stores, before a purchase is made. Examples are women's and children's wearing apparel, toys, women's gloves, and chinaware. The consumer wants a variety of prices, styles, and qualities from which to select. The price to be paid

¹ *Principles of Merchandising*, Chaps. II, III, IV.

is not clearly defined before the time of purchase. The purchase of shopping goods is not usually necessary as soon as the need is recognized; a delay is possible because this type of good is likely to possess an appreciable degree of durability, which permits time for shopping.

Specialty goods are those which have some particular attraction for the consumer, other than price, which induces him to put forth special effort to visit the store where they are sold and to make the purchase without shopping. The purchaser usually determines in advance the type of merchandise he expects to buy and the store in which he will buy it. He will search for it, wait for it, and go for it. Examples are men's clothing, shoes, high-grade furniture, vacuum cleaners, radios, farm implements, watches, silverware, high-quality jewelry, and automobiles. Staple groceries are convenience goods, while fancy groceries fall in the specialty group; women's shoes with a strong style or novelty feature might be classed as shopping goods, men's work shoes as convenience goods, and high-quality, trade-marked, and advertised shoes as specialty goods. This type of merchandise is usually found in unit, department, chain, and, to a limited extent, mail-order stores. The manufacturer does not attempt universal distribution but selects his retail outlets very carefully, frequently using exclusive agencies. When wholesalers are used, the same careful selection is made. The producer may use the branch house plan, such as is used by farm implement, automobile, and power machinery manufacturing companies.

The dividing line between shopping goods and convenience goods, on one side, and between shopping goods and specialty goods, on the other, is not always clear. "Staple dry goods, low price, plain hosiery, and pins, needles, thread, and other small wares and notions, and also kitchen hardware, are examples of commodities that are merchandised both as shopping goods and as convenience goods."¹

Merchandise first introduced as a novelty, thus having shopping characteristics, may later become a specialty good. Shopping merchandise is typically sold in stores located in the central business districts, in outlying shopping centers of large cities, and on "main" streets.² Department stores, general stores, women's apparel shops, and mail-order stores are important agencies in the marketing of shopping goods. Such stores must be easily accessible to a large portion of the consumers in the retail trading area.

A large proportion of shopping merchandise, as might be expected, typically moves directly from the manufacturer to the retailer. The highly seasonal character of the demand, the great importance of the

¹ COPELAND, *op. cit.*, p. 67.

² Cf. PYLE, J. F., "The Determination of Standards of Location for Retail Concerns," *Harvard Business Review*, Vol. IV, No. 3, pp. 303-313.

style element, the importance of novelty and fad characteristics, the desire of store buyers to shop around and wait as long as possible before placing their orders, all promote direct marketing. There is, however, a considerable volume of business done through wholesalers. The small retailers typically buy through this middleman, and the large-scale retailers frequently use him for fill-in orders.

*The Demand Factors.*¹—The demand for consumer goods is large in the aggregate but obviously small-scale, and the unit of purchase is usually small. The unit purchase of many consumer durable goods, however, are large when measured in terms of cost. Houses, automobiles, pianos, oil burners, and electric refrigerators are examples of high-cost consumer merchandise. The volume of demand bears a close relationship to the degree of density of population, the purchasing power, and the standard of living of the community. Sales of many lines of consumer merchandise have been greatly increased through the use of time-payment plans. Some of the more important features of demand are demonstrated through the following illustrations and discussion.

Food and Kindred Products.—The demand for the necessary food products is comparatively stable. The consumption of this class of goods was apparently about as great during the depression period 1930–1934 as it was during the prosperity era of 1927–1929. There was probably some shifting from high-priced products to lower priced commodities, but the quantities used by the ultimate consumers declined very little.²

The estimated volume of food sales through grocery stores, combination grocery and meat stores, delicatessen shops, and the country general stores, through hotels and restaurants, and directly to consumers amounted to \$14,000,000,000 in 1933. According to estimates by the American Institute of Food Distribution, the food bill of the consumer was \$3,350,000,000 more in 1935 than it was in 1933; the average price of all food products rose considerably from 1933 to 1935.³

The character of the demand for food products has changed appreciably, however, during the last twenty years. Only a few years ago days were spent by the typical housewife in "putting up" vegetables, jams, preserves, and pickles, while today the factory packs these food articles in cartons, jars, cans, and bottles and sells them through the conveniently located retailer. The local grocery store has become the housewife's

¹ Cf. Chap. III.

² RAWLS, F. H., chief, Foodstuffs Division, U.S. Department of Commerce. Quoted from *Domestic Commerce*, Dec. 20, 1934.

³ Some estimates placed the average increase at 35 per cent. This is perhaps too high. The prices of meat products showed large increases, but many other products increased only slightly and some declined.

pantry. Not so long ago many varieties of food products were sold in bulk: sugar, coffee, flour, oatmeal, and other similar foods were scooped out of barrels; molasses, syrup, and vinegar were sold from jugs, casks, and kegs. Today the consumer prefers his food served under more sanitary conditions through modern stores.

The leading food-manufacturing industries, ranked on the basis of the value of their products, are slaughtering and meat packing; dairy products; bread and bakery products; flour, feed, and other grain mill products; canned foods; sugar refining (cane); coffee and spices; confectionery; and the beverage industry. The importance of the manufactured food-products industry is indicated by the following statistics.

There were in 1929 approximately 1,277 meat-packing plants in the United States which employed 122,500 wage earners, and whose output, valued at wholesale prices f.o.b. factory, was worth \$3,434,654,100. The number of plants declined to 1,073 in 1933, while the value of the production was \$1,487,920,253. The drastic decline in dollar volume represented a price decline rather than a physical-volume decline. The total value of meat-packing products in 1933 was divided as follows: fresh meat products, \$720,280,655; cured meat, \$293,679,481; lard, \$102,351,805; sausage, head cheese, etc., \$81,812,686; canned meats, almost \$19,000,000; and hides, skins, and pelts, \$54,303,318. There were 4,333,000,000 pounds of fresh beef, 500,000,000 pounds of veal, 3,250,000,000 pounds of fresh pork, and 1,875,000,000 pounds of lard produced in 1933.¹ These figures indicate in a forceful manner the changes that have taken place since the time when our forefathers slaughtered their farm stock for home consumption. An elaborate and efficient marketing organization is now necessary to supply the enormous consumer demand for meat. The consumer obviously desires large quantities of fresh meat. The high degree of perishability of this product complicates the problems of transportation and storage encountered during the marketing process. Modern refrigeration has solved this problem. Meat is distributed directly from the packer through his own branch houses and with the aid of refrigerator cars and trucks to the retail meat dealer, who preserves the product in the cooler until sold to the consumer.

The total value of the products of mills engaged primarily in grinding flour and meal amounted to approximately \$574,160,134 (f.o.b.) in 1933; \$598,000,000 in 1931; and \$1,061,000,000 in 1929. The total production of wheat flour in 1933 was almost 96,700,000 barrels valued in excess of \$430,000,000. This represents a decrease of 16.2 per cent in

¹ D. E. Montgomery, consumer counsel, stated that the 1920-1929 average supply of hog products for domestic consumption equaled 83 pounds per capita annually, while the amount available for the marketing year beginning Nov. 1, 1935, would be only 47 pounds.

quantity and 4.6 per cent in value from 1931. These figures do not include cereal preparations and prepared feeds for live stock and poultry.

The great increase in the demand for bakery products reflects another fundamental change in our living habits. Much of the baking activity of the home has been transferred to the factory. The total f.o.b. value of bakery products in 1931 was almost \$1,188,000,000; in 1933 the value declined 22.7 per cent, to \$918,000,000. The value in 1929 was in excess of \$1,500,000,000. The principal items produced in 1933 were bread, rolls, coffee cake, and similar products, valued at almost \$530,000,000 and weighing in excess of 8,203,000,000 pounds; crackers, valued at almost \$141,540,000 and weighing nearly 1,045,000,000 pounds; and soft cake, valued at more than \$100,000,000. Bread and the other items in that class declined 9.8 per cent in quantity and 10.9 per cent in value from 1931 to 1933. Bakery products are sold directly to the consumer, from the bakery store and from wagons; indirectly, through chain retail stores and independent food stores. Several food chains produce large quantities of bakery goods and sell them through their own retail outlets. These same chains also sell the bakery products of independent bakeries that have established a strong consumer demand through aggressive advertising.

The canning factory has taken the place of home canning to a considerable extent. The value of canned and processed fruits and vegetables was \$704,665,763 in 1929, in excess of \$471,600,000 in 1931, and approximately \$410,400,000 in 1933. There were more than 18,500,000 cases of canned vegetables and soups, approximately 33,000,000 cases of canned fruits, and almost 1,000,000,000 pounds of dried fruits produced in 1933. Confectionery products, including salted nuts, had an aggregate value in 1933 of \$204,525,000, a decrease of 27.5 per cent from 1931. The more important items in this group were chocolates, 280,416,000 pounds, with a value of \$57,400,000; bars, 415,386,000 pounds, with a value of \$51,507,000; hard candy, 206,000,000 pounds, with a value of almost \$22,000,000; and salted nuts, valued at almost \$11,000,000. Malt liquors produced in 1933 equaled 26,009,429 barrels, with a total value in excess of \$42,500,000. The quantity and value of soft drinks ran into large figures.

Each of these various classes of food products presents individual marketing problems, due to the peculiar characteristics of the product, the method of production, the demand, and the buying habits of the consumers. According to the *Census of Distribution*, the consumer in cities of 10,000 population and more paid \$138 in 1929 for his food. Restaurants, exclusive of hotels, received \$30. The expenditure for food represented 23.04 per cent of the consumer's total outlay, with the restaurant getting 5.04 per cent. During the depression a larger per-

centage of the total outlay went for food products. The consumer, from the force of necessity, reduced his expenditures for durable consumer goods and kept up his purchases of necessary food products. Food prices, in November, 1934, were 28 per cent higher than in April, 1933, but they were still 27 per cent below those of November, 1929.

Table 67 indicates the size of the family demand for twelve different food products generally sold through food stores. These estimates are based on reports that cover the year preceding each date. Thus the figures under 1935 refer to the consumption during 1934.

TABLE 67.—PER CAPITA CONSUMPTION OF SELECTED FOOD PRODUCTS BY MILWAUKEE FAMILY

Per family consumption in Milwaukee

Product	Unit	Units per family per year				
		1935	1934	1931	1930	1929
Canned soups.....	Cans	73.7	67.9	57.0	75.4	75.4
Bottled catsup.....	Bottles	27.5	25.1	28.7	27.9	29.0
Packaged tea.....	Pounds	5.8	3.7	3.4	3.2	3.1
Packaged coffee.....	Pounds	46.8	47.4	46.3	45.8	45.6
Wheat breakfast foods..	Packages	25.2	24.7	19.6	25.2	28.8
Canned milk.....	Cans	125.7	105.8	96.5	86.2	80.6
Wheat bread.....	Loaves	228.0	229.0	241.0	195.0	230.0
Baking powders.....	Ounces	83.2	68.4	78.9		64.4
Packaged bacon.....	Pounds	31.8	29.5	30.6		28.5
Prepared mayonnaise...	Jars	18.8	21.6	23.8		27.0
Packaged cheese.....	Packages	33.6	33.8	34.0		33.0
Packaged butter ²	Pounds		94.4	84.4		114.4

¹ Table compiled from "Consumer Analysis of Greater Milwaukee Market, 1935," *The Milwaukee Jour.*

² Figures for 1935 not given.

Clothing.—The demand for clothing is as universal, pervasive, and as persistent as that for food. There are, however, some important differences between the characteristics of the demand for these two classes of consumer-manufactured goods. Clothing is much more durable; purchases are made at much less frequent intervals; and the style element is an important factor.

How the demand for different items of clothing is affected by the economic status of both men and women is indicated in Tables 68 and 69. An examination of these tables suggests the difference in the amount of money expended for clothing by men and women. Judging from these figures, it appears that women spend more than men. These data give one some idea, at least, as to how the purchases of the worker and his

wife are affected by the nature of his occupation and the size of his income. The expenditures of women for outerwear, hats, underwear, stockings, shoes, and miscellaneous articles increase rapidly with increased income, irrespective of whether this increase results from their own activity or that of their husbands. The men likewise spend more for articles of clothing, such as ties, shoes, hats, and suits, as their incomes increase and they enjoy more responsible positions. The need for better quality of clothing by the professional class accounts for a portion of the increase.

TABLE 68.—ESTIMATED COSTS AND CLASSIFICATION OF CLOTHING EXPENSES FOR MEN¹

(By various standards of living)

Classes of clothing	Male industrial worker, Boston ²	Male office worker, Brooklyn, N. Y. ³	Man at professional standard ⁴
1. Hats.....	\$ 3.83	\$ 4.83	\$11.83
2. Outerwear.....	25.59	31.74	99.43
3. Shirts.....	5.78	7.35	18.50
4. Underwear.....	5.58	6.28	11.00
5. Socks.....	2.28	1.76	9.50
6. Shoes.....	8.06	10.23	23.66
7. Gloves.....	1.11	1.57	4.00
8. Collars.....	0.76	2.28	3.50
9. Ties.....	1.56	1.86	13.50
10. Handkerchiefs.....	0.54	0.72	4.50
11. Miscellaneous.....	8.86	1.52	9.14
12. Incidentals.....	1.00	1.00	
13. Upkeep.....	5.48	7.68	28.75
Total.....	\$70.43	\$78.82	\$237.31

¹ Quoted from Paul H. Nystrom, *Economics of Consumption*, p. 342.

² *The Cost of Living in Twelve Industrial Cities*, National Industrial Conference Board, Inc., New York, 1928.

³ *Cost of Living in New York City, 1926*, National Industrial Conference Board, Inc., New York, 1926.

⁴ *Quantity and Cost Estimate of the Standard of Living of the Professional Class*, University of California Press, 1928.

More recent figures on the cost of living for families in different income and occupational groups were published in 1935 by the Heller Committee for Research in Social Economics, University of California. The information covers the years 1929 to 1934, inclusive, thus furnishing a basis for comparison.

Table 70 gives the data for a group of business executives. The total costs declined from \$6,868.31 in 1929 to \$5,456.77 in 1933, then increased to \$5,590.88 in 1934. The decline in costs no doubt reflects changes in

income. It is interesting to note that the executives' lunches cost more in 1933 and 1934 than they did in 1929, 1930, and 1931. Expenditures for food, clothing, and shelter declined substantially, while the amount spent for the miscellaneous group remained almost the same throughout the period. The decline in the food, clothing, and shelter groups reflects the fall in prices for these goods.¹ Many of the items in the miscellaneous group are of the "overhead-cost" variety which cannot be reduced except at tremendous sacrifice and inconvenience. The proportion of total costs expended for this list of items increased from 33 per cent in 1929 to 41 per cent in 1932 and 1934. The relative amount expended for shelter decreased from 37 per cent in 1929 to 34 per cent in 1932 and to 31 per cent in 1934; the proportion going for food and clothing remained fairly stable.

TABLE 69.—ESTIMATED COSTS AND CLASSIFICATIONS OF CLOTHING EXPENSES FOR WOMEN¹
(By various standards of living)

Classes of clothing	Wife of industrial worker, Springfield, Mass. ²	Wife of office worker New York ³	Single woman office worker ⁴	Wife of professional man ⁵
1. Hats.....	\$ 4.09	\$ 5.78	\$ 9.50	\$ 30.00
2. Outerwear.....	21.35	38.99	91.25	246.73
3. Underwear.....	11.57	11.18	17.28	48.46
4. Stockings.....	3.90	3.72	15.00	19.50
5. Shoes.....	7.74	8.93	26.30	48.97
6. Gloves.....	0.89	1.19	3.25	8.00
7. Handkerchiefs.....	0.54	0.48	1.20	4.50
8. Miscellaneous.....	0.84	0.72	8.55	14.17
9. Incidentals.....	5.00	5.00	5.50	12.00
10. Upkeep.....	4.38	6.22	.....	12.50
Total.....	\$60.30	\$82.21	\$177.83	\$424.83

¹ Quoted from Paul H. Nystrom, *Economics of Consumption*, p. 343.

² *The Cost of Living in Twelve Industrial Cities*, National Industrial Conference Board, Inc., New York, 1928.

³ *Cost of Living in New York City, 1926*, National Industrial Conference Board, Inc., New York, 1926.

⁴ *Clothes, Money and the Working Girl*, Milwaukee Vocational School, Milwaukee, Wis.

⁵ *Quantity and Cost Estimate of the Standard of Living of the Professional Class*, University of California Press, 1928.

The total costs of the clerk (see Table 71) show that his expenditures reached the lowest point in 1932. This group of consumers increased its expenditures for "miscellaneous" goods and services. Such items as carfare, life insurance, medical care, education, and church and charity

remained identical for each of the years. No provision is listed for automobile upkeep. The proportion of expenditures going for shelter increased slightly in 1932 but declined in 1934. The relative expenditures for food and clothing dropped in 1932 but were back to approximately the 1929 ratio in 1934.

TABLE 70.—COST OF LIVING BUDGET FOR EXECUTIVE¹

Items	1929	% of total cost	1931	1932	% of total cost	1933, including sales tax	1934, including sales tax	% of total cost	
Total cost..	\$6,868.31		\$6,501.3	\$6,098.69		\$5,456.77	\$5,590.88		
Income tax.	19.99		21.58	12.37		62.71	49.86		
Food.	1,082.02	16	6.02	898.41	748.27	14	792.82	835.24	15
Meals at home.....	932.02			748.41	613.27		639.07	682.24	
Husband's lunches...	150.00			150.00	135.00		153.75	153.00	
Clothing and upkeep...	950.42	14	819.84	672.19	582.01		693.12	705.94	13
Replacements.....	899.29		771.53	630.65	548.67		648.86	674.21	
Upkeep.....	51.13		48.31	41.54	33.34		44.26	31.73	
Shelter.....	2,539.18	37	2,414.07	2,271.84	1,858.48	34	1,664.78	1,741.16	
Housing.....	1,571.55		1,499.15	1,380.94	1,066.48		915.58	929.51	
House operation.....	697.44		652.60	662.88	587.92		525.74	569.82	
Light and fuel.....	199.05		180.12	192.00	180.15		183.68	180.88	
Service.....	300.00		300.50	300.50	236.62		171.00	217.88	
Other.....	198.39		171.98	170.18	171.15		171.06	171.06	
Furnishings.....	270.19		262.32	228.22	204.08		223.46	241.83	
Miscellaneous.....	2,276.70	33	2,259.82	2,243.88	2,214.79	41	2,243.34	2,258.68	41
Care of the person.....	75.13		72.15	68.43	84.53		96.89	89.35	
Leisure-time activities...	549.80		535.60	517.18	478.41		479.93	487.41	
Automobile upkeep.....	409.77		410.07	416.27	419.85		429.39	444.79	
Carsfare.....	40.00		40.00	40.00	40.00		40.00	40.00	
Investments.....	620.00		620.00	620.00	620.00		620.00	620.00	
Medical care.....	275.00		275.00	275.00	275.00		275.00	275.00	
Association dues.....	36.00		36.00	36.00	36.00		36.00	36.00	
Education.....	101.00		101.00	101.00	101.00		101.13	101.13	
Church, and charity.....	110.00		110.00	110.00	100.00		105.00	105.00	
Incidentals.....	60.00		60.00	60.00	60.00		60.00	60.00	

¹ Adapted from a Report by the Heller Committee for Research in Social Economics, University of California, 1935; tables published in *Domestic Commerce*, Apr. 20, 1935.

* Natural gas introduced. Electricity increased to cover electric refrigerator; power for radio now included here instead of in leisure time.

† Permanent waves and finger waves added for the wife.

‡ No provision for dependents outside home; therefore no increase in costs.

Table 72 gives the budget for a wage earner, whose expenditures decreased each year to and including 1932. He spends a larger percentage of his total for food than either of the other two groups, and there was a greater decline in the percentage during the depression than for the other groups. The relative expenditures for clothing are greater

than those of the executive but less than those of the clerk. This item dropped in 1932 but was back to the 1929 level in 1934. Costs for shelter rose in 1932 but declined in 1934.

TABLE 71.—COST OF LIVING BUDGET FOR CLERK¹

Items	1929	% of total cost	1930	1932	% of total	including sales tax	1934, including sales tax	% of total cost
Total cost.....	\$2,484.31		2,336.88	\$2,156.19	\$1,936.22	1,964.81	\$2,033.41	
Food.....	739.12	30	694.10	611.03	530.08	566.48	599.43	29
Meals at home.....	634.12		589.10	506.03	440.08	457.85	491.43	
Husband's lunches.....	105.00		105.00	105.00	90.00	107.63	108.00	
Clothing and upkeep....	442.75	18	405.35	339.97	291.69	344.92	360.24	18
Replacements.....	418.56		381.42	319.60	277.63	326.97	346.17	
Upkeep.....	24.1		23.93	20.37	14.06	17.95	14.07	
Shelter.....	758.95	31	706.52	633.81	610.75	540.92	568.26	28
Housing.....	480.00		450.00	396.00	384.00	318.00	330.00	
House operation.....	185.63		165.92	158.99	156.26	154.80	154.56	
Light and fuel.....	104.86		88.07	90.86	88.76	90.66	88.84	
Other.....	80.77		77.85	68.13‡	67.50	64.14	65.72	
Furnishings.....	93.32		90.60	78.82	70.49	77.12		
Miscellaneous.....	543.4	21	530.91	521.38	503.70	504.49	505.48	25
Care of person.....	56.7		55.56	53.34	47.76	53.12	47.15	
Leisure-time activities	198.7		187.35	180.04	169.94	163.24	170.20	
Carsfare.....	60.00		60.00	60.00	60.00	60.00	60.00	
Life insurance.....	130.00		130.00	130.00	130.00	130.00	130.00	
Medical care.....	75.00		75.00	75.00	75.00	75.00	75.00	
Education.....	5.00		5.00	5.00	5.00	5.13	5.18	
Church and charity*..	18.0		18.00	18.00	16.00	18.00	18.00	

¹ *Ibid.*

* No provision for dependents outside the home; therefore no increase in costs.

† The estimate published in 1933 has been reduced \$36 as the result of an error in calculating rents.

‡ Natural gas introduced; power for radio now here instead of in leisure time.

§ Telephone costs reduced by introduction of two-party, limited-call line.

A comparatively small volume of clothing is made in the home in modern times. The Census figures aid one in visualizing the tremendous importance of marketing in supplying the modern demand for factory-made articles of clothing. The total value (f.o.b.) of all products made by establishments engaged primarily in the manufacture of women's and children's clothing amounted to \$796,000,000 in 1933; almost \$1,220,000,000 in 1931; and approximately \$1,605,221,000 in 1929. The more important items in this group were women's, misses', and juniors' one-piece dresses, with a total value in excess of \$376,000,000, and separate coats with a value slightly less than \$150,000,000. The value of knitting-mill products was approximately \$498,300,000 in 1933.

and almost \$900,000,000 in 1929. Hosiery, except infants', athletic, and golf, amounted to 94,000,000 dozen pairs, with a value of \$247,000,000 in 1933. About 32,000,000 dozen pairs of full-fashioned hose, valued at \$162,500,000, and almost 68,000,000 dozen pairs of seamless hose, valued at \$91,134,720, were produced in 1933. The value of millinery goods produced in 1933 was almost \$77,174,000. This was only slightly more than half the value of the 1931 output and only about 40 per cent of the 1929 value. The decline in total value reflects the drastic fall in prices and postponed purchases.

TABLE 72.—COST OF LIVING BUDGET FOR WAGE EARNER¹

Item	1929	% of total cost	1930	1931	1932	% of total cost	1933	1934	% of total cost
Total cost.....	\$1,926.48		\$1,816.36	\$1,624.61	\$1,455.13		\$1,495.57	\$1,544.16	
Food, at home.....	663.18		601.50	502.03	438.36		462.64	496.76	33
Clothing and upkeep...	298.20		272.04	225.87	179.73		215.59	226.56	15
Replacements.....	283.14		257.35	212.57	169.60		202.89	216.42	
Upkeep.....	15.06		14.69	13.30	10.13		12.70	10.14	
Shelter.....	565.60	30	553.68	514.97	471.26	32	446.67	449.68	29
Housing.....	360.00		360.00	336.00	300.00		270.00	270.00	
House operation.....	143.45		133.35	126.48	124.32		125.39	123.90	
Light and fuel.....	86.44		77.63†	80.42	78.32		80.22	78.40	
Other.....	57.02		55.72	46.06‡	46.00		45.17	45.50	
Furnishings.....	62.14		60.33	52.49	46.94		51.28	55.78	
Miscellaneous.....	399.50	21	389.14	381.74	365.78	26	370.67	371.18	24
Care of person.....	45.50		46.54	45.16	39.94		44.17	39.27	
Leisure-time activities	146.00		134.60	128.58	119.84		118.37	123.76	
Carfare.....	45.00		45.00	45.00	45.00		45.00	45.00	
Life insurance.....	65.00		65.00	65.00	65.00		65.00	65.00	
Medical care.....	75.00		75.00	75.00	75.00		75.00	75.00	
Education.....	5.00		5.00	5.00	5.00		5.13	5.13	
Church and charity*	18.00		18.00	18.00	16.00		18.00	18.00	

¹ *Ibid.*

* No provision for dependents outside the home; therefore no increase in costs.

† Natural gas introduced; power for radio now included here instead of in leisure time.

‡ Telephone costs reduced by introduction of two-party, limited-call line.

The total value of all products made by establishments engaged primarily in the manufacture of men's, youths', and boys' clothing at f.o.b. prices was in excess of \$410,000,000 in 1933. The principal items were men's and youths' woolen and worsted suits, valued at \$225,458,000; overcoats and topcoats, \$54,365,843; separate trousers, \$25,620,000; leather garments, \$13,000,000; and boys' woolen and worsted suits,

\$12,800,000. Men's furnishing goods were valued at more than \$54,000,000. More than 8,000,000 dozen neckties, valued at almost \$30,250,000; almost 7,000,000 dozen suits of athletic underwear, valued at \$16,360,000; and 1,635,382 bathrobes and lounging garments, with a wholesale f.o.b. value in excess of \$5,100,000 were produced in 1933. The total production of boots and shoes in 1933, not including rubber footwear, amounted to almost 350,000,000 pairs, with a wholesale value of \$547,873,000. The number of pairs produced in 1931 was less than in 1933, but the value was greater. This indicates that people were buying lower priced shoes and were using more pairs. The value of the 1929 production was almost \$966,000,000. The average price of clothing rose about 25 per cent from 1933 to 1935, according to estimates which appear to be fairly accurate.

It is interesting to note that the value of perfumes, cosmetics, and other toilet preparations was in excess of \$108,000,000 in 1933; the value of dentifrices was in excess of \$25,000,000. Patent and proprietary packaged medicines and compounds equaled more than \$104,600,000. The aggregate value of the products of the drug industries, excepting drug grinding, was almost \$400,000,000.

Shelter.—This classification comprises expenditures for both the house and all the equipment and furnishings used in and about the home. The demand for housing and home furnishings is constant, yet the expenditures for these articles may vary widely from year to year. The ability and the desire of the consumer to buy new goods in this classification depend upon his standard of living and upon his purchasing power. Since houses are usually built with a considerable amount of borrowed money, the credit situation may be a determining factor in the demand for residences. Houses are built by individual home owners only at long intervals, perhaps not more than one or two during a lifetime. Many articles of furniture and musical instruments are not regarded as repeat merchandise. The seller has to depend largely upon the creation of new families, increased purchasing power, rising standards of living, and obsolescence and destruction for stability and growth in his volume of sale. The shift of the population from the farm to the city and restricted building during the war period created an abnormal demand, during the period 1920–1928, for new buildings and home furnishings. During the depression period 1930–1935 the demand for houses was only a small fraction of the earlier period. A large delayed demand developed during this period.

The importance of the demand for shelter is indicated by construction figures for residential purposes. Production figures for articles used in the home also reflect the importance of this demand. The value of household furniture, f.o.b. factory, produced in 1933, was in excess of

\$244,000,000; it was almost \$351,000,000 in 1931.¹ The total production of domestic electrical refrigerators in 1933 was 956,356 units, with a value of almost \$75,500,000, as against a production of 708,894 units, with a value of almost \$90,500,000 in 1931. Many lower priced units were produced in 1933, 1934, and 1935. Laundry equipment, parts, and accessories produced in 1933 had a value of \$42,882,000. Electric washing machines, in excess of 1,000,000 units, were produced in that year, having a value of \$37,000,000. The number produced in 1931 was only 810,338, but their value was in excess of \$39,300,000. Thus sales in units increased, while prices per unit declined. The value of the production of vacuum cleaners declined from \$24,800,000 in 1931 to \$14,200,000 in 1933; sewing machines declined from 231,569, valued at \$76,000,000, in 1931 to 128,000, valued at \$4,330,000, in 1933. The value of pianos declined from \$42,501,000 in 1929 to \$8,590,260 in 1933, while the value of organs declined from \$17,322,000 to \$1,626,804. The demand for these goods evidently is quite inelastic. The volume of sales cannot be materially stimulated by price reductions. A decrease in purchasing power for large groups of people is immediately reflected in greatly reduced buying. This, of course, then leads to reduced production and to unemployment.

C. H. Lang² said in 1935 that

. . . there are 3,000,000 old and ramshackle homes in the United States hardly worth wrecking; 5,000,000 American families live in tenements and houses below the standard of decency. Modern housing should be provided. There are 10,000,000 houses in the United States that have no electric lights; 9,000,000 have no bath rooms; and 14,000,000 have no electric refrigerators; 10,000,000 radio sets are obsolete.

The Durable Industries Committee estimated that to keep the country built up to standards set by our living requirements would require \$2,000,000,000 a year for new housing and \$1,000,000,000 annually to keep houses modern. The "costs" of housing increased only about 4 per cent from 1933 to 1935.

Automotive Products.—The demand for automobiles and automotive equipment and supplies was one of the outstanding phenomena of the decade 1920-1930. The desire of the consumer for mechanical transportation, the comforts and pleasures to be derived from the use of the modern automobile, the satisfaction that comes from owning and driving

* ¹ Retail sales of furniture in 1934 increased 34.6 per cent over those of 1933 thus reflecting the increased purchasing power of consumers. The largest gains were in the following departments: house furnishings, carpets and rugs, kitchen furniture, radios, and beds and bedding. Quoted from *Domestic Commerce*, May 20, 1935.

² Publicity director, General Electric Company. Quoted from *American Business*, May, 1935.

a beautiful car, and the effect of such ownership upon the consumer's social standing caused him to make great sacrifices to buy the machine. The partial-payment plan made it possible for thousands of people, who otherwise could not have financed the purchase, to own a motor car. The want has been strong enough to cause people to curtail purchases of many other articles hitherto regarded as necessary and to pay large sums in the form of taxes for the purpose of constructing better highways. Large expenditures for gasoline, oil, and tires are necessary to keep the automobile in operation. The quality of car bought depends to a considerable extent upon the purchasing power of the consumer, his standard of living, and personal ambition.

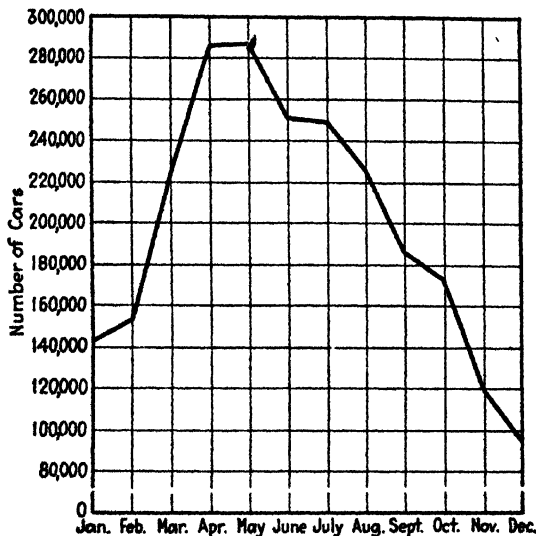


CHART X.—New passenger-car registrations in the United States, monthly average—1927–1933.

The demand for automobiles on the part of the consumer is very persistent. Although the severe depression of 1930–1933 forced many people to drive their old cars longer than they intended and thus delayed their purchase of a new car, sales of new cars began to increase with the first increase in purchasing power. The automobile industry was given credit, in fact, for being a big factor in overcoming the depression. The demand for this product is quite seasonal. Chart X shows the monthly average for the seven-year period 1927–1933, inclusive, of new passenger-car registrations. The peak of sales is usually attained in April and May. Sales are at their lowest point in November, December, and January. Attempts are being made to even out the demand by introducing new models during the year. The fundamental reason

for the seasonal variation is the weather. People in the northern part of the United States, even though they have many miles of hard-surfaced roads, snow-removal service, closed cars, and heaters, prefer to buy a new car in the spring of the year. It is possible, however, that a considerable volume of sales can be developed during September, October, and November which will aid in smoothing the sales curve. This in turn will permit more stable employment in the factories. There were in 1935, according to C. H. Lang,¹ 7,000,000 automobiles seven years old or older in the United States; they were dangerous and obsolete and should have been replaced; in addition, there were 2,000,000 less cars in operation than in 1930. An appreciable amount of this deficiency was made up during 1935.

The Oil Refining Industry.—The importance of the petroleum refining industry as a source of consumer manufactured goods is indicated by the number of firms, the number of employees, the size of the payroll, and the value of the output. There were 390 major firms in 1929 which employed 80,596 workers, and paid them almost \$131,177,000 in wages. The same number of firms in 1933 employed 69,055 workers, and paid them \$89,701,561. The value of the output of the establishments engaged primarily in petroleum refining in the United States was \$1,378,-838,372 in 1933. The value was \$2,639,665,000 in 1929. The more important items produced are gasoline, naphtha, benzene, fuel oil, illuminating oils, lubricating oils, and greases.

The marketing of petroleum products, especially gasoline, was thrown into a chaotic condition during the depression of the thirties. The excess production of crude oil was reflected in excess refining capacity and the great increase in the number of filling stations. The expansion in the number of filling stations was due to a number of factors, one of which was the practice of refiners of loaning and leasing equipment to station operators on a basis which practically meant a gift. One refiner starts such a plan, and others follow. An increase in the margin allowed operators tends to encourage the establishment of new stations. A number of unemployed people during the early part of the depression attempted to earn a livelihood by establishing their own stations.

The demand for gasoline is inelastic, within certain limits, but it is subject to seasonal variations. Large numbers of people continue to spend money for motor fuel even though their incomes have declined greatly, and an increase in price does not materially reduce purchases. They seem to prefer to go without many other commodities rather than abandon their cars. This situation makes gasoline an ideal commodity for a sales tax. The federal government, the state governments, and many counties and municipalities have taken advantage of the situation,

¹ *Ibid.*

and are taxing automobiles, gasoline, and oil. The total tax bill of the 24,913,403 American motorists for 1934 was 1,200,107,729, of which the state gasoline taxes and federal excise taxes amounted to \$817,178,729.¹

Motorists are required to pay too much for gasoline and oil, according to W. S. Farish,² but this is due to the high operating costs of the refining companies. Prices, however, must remain high if the refiners are to stay in business. The costs are high because of the overcapacity in refining and the overproduction of crude oil. "There are three times too many filling stations, two pipe lines for every one needed, and refineries never run more than 60 per cent capacity."³ The large integrated companies which produce a complete line of gasoline and oils, in order to protect their markets, formerly executed exclusive contracts with retailers. This prevented many small manufacturers of lubricating oils and greases from securing suitable retail outlets. According to some estimates, by 1933 approximately 65 per cent of the retail dealers were under exclusive contracts. In March, 1935, Oil Administrator Ickes issued an order prohibiting the enforcement of exclusive conditions in the retail sale of lubricants. Service stations were permitted to handle gasoline exclusively on existing contracts, but no new contracts could be written, and existing contracts could be canceled on thirty days' notice.⁴

Farm Equipment and Supplies.—Since farm machinery and equipment are used for productive rather than for consumptive purposes, they apparently should be classed as industrial goods. The buying motives and habits of the farmer, however, are those of the consumer rather than those of the industrial buyer.

The sale of power machinery to farmers was in large quantities during the period 1925–1930. A study of 1929 assessors' reports of nearly 170,000 Indiana farms showed that 87 per cent of the farmers had automobiles, 22 per cent had radios, 16 per cent had tractors, 14 per cent electricity, 13 per cent trucks, 12 per cent silos, 9 per cent furnaces, 5 per cent bath facilities, and 4 per cent electric plants.⁵ If these figures are at all representative, the farm market absorbs a large number of automobiles and quite a few radios and tractors, but a great scarcity of electric plants, furnaces, silos, and trucks apparently exists. The American farmer has begun to think in terms of modern business efficiency. As he moves more rapidly toward this goal, the demand for power machinery and other farm equipment will increase.

The value at the factory of agricultural machinery produced in 1933 was approximately \$16,000,000; the value of the 1931 production was •

¹ *Automobile Facts and Figures*, 1935 edition.

² Chairman of the Board of Directors of the Standard Oil Company of New Jersey.

³ *Ibid.* Quoted from the *New York Journal of Commerce*, Nov. 15, 1934.

⁴ *Business Week*, March 16, 1935.

⁵ *Indiana Business Review*, Vol. IV, No. 12, p. 4.

approximately \$50,000,000. The drastic decline reflects the low purchasing power of the farmers at that time. The farmer typically buys his machinery, trucks, silos, and other articles requiring a comparatively large outlay of money, on credit. When credit is not available, he cannot buy. Since these goods are durable, purchase for replacement may be delayed for from one to several seasons by making necessary repairs. The demand is inelastic. The increased income received by the farmers during 1934 and 1935 was promptly reflected in increased purchases of machine and other supplies.

Factors That Control the Individual Consumer's Choice.—While it is clearly evident that consumers are in constant need of food, clothing, shelter, house furnishings, and automotive equipment, it is common knowledge that the purchase of the particular quality, style, brand, and quantity of any particular class of merchandise is conditioned by such factors as the size of the family, the occupation of the supporting members of the household, its geographical location, its income and standard of living, the season of the year, and the sales-promotion activities of the various manufacturers and merchants. Competition among the producers is keen, merchandise is identified by trade-marks, and large sums of money are spent in an attempt to develop consumer recognition and acceptance of individual producers' merchandise.

Supply Factors.—Consumer goods are both perishable and non-perishable; there is a constant attempt to give them a higher degree of non-perishability through processing. While a large quantity is produced under small-scale conditions, the greater amount is produced under large-scale methods. The meat packing, steel, automobile, and tire industries, the large farm implement plants, the high degree of specialization found in shoe factories, and the large capital investment in the sugar refinery business, all exemplify large-scale methods. The merger movement, since 1925, has been prominent among industries producing consumer goods. The dairy industry and general food products companies furnish excellent examples of this practice. There is a strong tendency for producers of consumer goods to locate near their markets unless the problem of securing raw materials dictates otherwise.

Methods of Marketing.—Consumer goods typically reach the purchaser through a retail store which may be supplied directly from the factory or through a wholesaler, branch house, or public warehouse. The small-scale demand necessitates convenience and accessibility in the location of the storehouse, a variety of grades, styles, sizes, designs, prices, and other qualities. A number of services, such as credit, delivery, demonstration, repair, adjustment, fitting, and many others which the manufacturer cannot economically give, are expected by the consumer. The buying habits and patronage motives mentioned previously play

an important part in determining the kind and quality of store in which any particular article of merchandise should be sold. Many of the distinctions commonly made among stores that were valid in 1925, were obsolete by 1934. Cigar, drug, grocery, shoe, and many other stores have ceased to be what the name might imply, and have greatly widened the lines of merchandise carried.

A number of manufacturers sell through their own retail stores; others, for example the large meat packers and farm implement companies, use the branch-house system to distribute to the independent retailer.

Goods of a complicated mechanical nature, that are likely to need frequent repairs and services, have to be sold and serviced under the close supervision of the producer if satisfactory results are to be secured. The independent middleman is not always satisfactory when it comes to rendering efficient and reliable service after the goods have been sold. Some automobile companies apparently are finding it advisable to establish factory branches which keep in close touch with the independent dealer. A comparatively large number of producers sell directly to large-scale retailers and indirectly to small-scale retailers. This plan is dictated by the relative costs of selling to each group through the various classes of middlemen.

The manufacturer usually finds it advantageous to sell through the wholesaler when: (1) he wants to secure universal distribution for his product; (2) he wishes to sell to a large number of small retailers scattered over a wide territory; or (3) when he produces only one line or a restricted line of merchandise, of which the typical retailer buys only a few dollars' worth at a time. Some producers, such as cheese and canning factories, use the broker to find a market for their goods; other firms use selling houses.

Methods Used in Selected Industries.—Chart XI indicates the general paths followed by manufactured goods going from the producer to the user. The user or consumer may be, as we learned previously, an organization, an institution, or the ultimate consumer. What particular route the goods will follow in going to either kind of buyer will depend on the policy of the selling firm, and the buying practice of the purchaser. These are influenced by the characteristics of the product, the methods of production, the marketing organization available, economic, political, and social forces and conditions.

The methods used in marketing some selected products are given for illustrative purposes. This information is based on reports from the 1930 Census.

The manufacturers of wallpaper disposed of 67 per cent of their output through the wholesaler and 32.8 per cent directly to the retailer.

while only 0.2 per cent was sold directly to the householder. Of the output of wool carpets and 61.2 per cent was sold through wholesalers, and 37 per cent direct to retailers. The producers of men's straw hats sold 55.5 per cent their production to retailers, 34 per cent through wholesalers, and 10.1 per cent to manufacturers' wholesale branches. Of suspenders, garters, and like goods 52.9 per cent was sold through the wholesaler, and 42.6 per cent direct to retailers.

Manufacturers of optical goods sold 66.3 per cent of their output to their own sales branches and to wholesalers, while 22 per cent was sold directly to industrial and other large consumers; 10.9 per cent was sold to retailers. Manufacturers of fountain pens, stylographic pens, and pen points sold 75.3 per cent of their products directly through their own stores and to independent retailers, and 21.5 per cent through

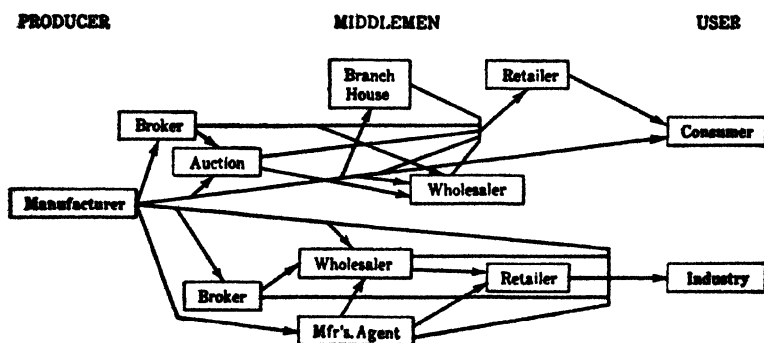


CHART XI.—The marketing of manufactured products. This illustrates in a simplified manner the typical channels of distribution followed by consumer and industrial goods in their journey from the manufacturers to the ultimate users.

wholesale channels. Forty-nine and one half per cent of the silverware output was sold directly to retailers by the manufacturers, 36.8 per cent was disposed of to the manufacturers' own wholesale branches, and 11.7 per cent went to independent wholesalers.

Manufacturers of corn syrup, sugar, oil, and starch sold 54.8 per cent of their output through wholesale establishments of all kinds, and 45.2 per cent was sold directly to industrial and other large consumers who bought at wholesale. The producers utilized the services of manufacturers' agents, selling agents, brokers, and commission houses to negotiate 11.4 per cent of the total volume of sales. The sale of chewing gum to the extent of 86.1 per cent of the total output was made through wholesalers, while 13.7 per cent was made direct to retailers. Chocolate and cocoa products, likewise, were sold principally through wholesalers, 69.3 per cent of the volume being disposed of by this method; 16.4 per cent was sold to retailers, 9.1 per cent through manufacturers' own wholesale branches, and 5.2 per cent to industries.

The manufacturers of flour and cereal products, with sales of \$1,235,492,000 in 1929, sold 47.3 per cent through wholesalers, 20.4 per cent to industrial users, 12.7 per cent to non-chain retailers, 11.8 per cent to chain-store warehouses, 6.6 per cent through their own wholesale branches, and 1.2 per cent through their own retail branches. Of the above amount \$209,939,000 was sold through agents and brokers, and \$90,250,000 was exported.

Manufacturers of baking powder, yeast, and other leavening compounds sold 39.9 per cent of their goods to wholesalers, 48.4 per cent to manufacturers sales branches, 9.9 per cent direct to retailers, and 1.8 per cent direct to industrial and other large consumers who bought at wholesale. Manufacturers of biscuits and crackers, on the other hand, sold principally through their own wholesale branches; 53.9 per cent was distributed by this method, 34.4 per cent was sold direct to retailers, 8 per cent to wholesalers, and 3.1 per cent to manufacturers' own retail branches.

The wholesaler received directly from the manufacturer 63.2 per cent of the flavoring extracts and flavoring syrups produced. The remainder of the output was disposed of as follows: 13.8 per cent directly to retailers, 9.9 per cent to industrial consumers, 7.6 per cent to manufacturers' own retail outlets, and 1.7 per cent to household consumers. The manufacturer utilized the services of manufacturers' agents, selling agents, and commission houses in disposing of 16.1 per cent of the total volume of sales.

Match manufacturers made 72.7 per cent of their sales through their own wholesale branches, 22.5 per cent to independent wholesalers, and 5.2 per cent to retailers.

Only 16.1 per cent of sewing machines, parts, and cases was sold through wholesalers, while 65.9 per cent was sold through manufacturers' retail outlets, and 18 per cent direct to industrial users who bought at wholesale prices; 2.8 per cent was sold through manufacturers' agents, selling agents, brokers, and commission houses. Manufacturers of typewriters and parts sold chiefly through their own retail sales branches, 67.6 per cent of the sales reaching the ultimate user by this method; 20.6 per cent was sold to wholesalers and through manufacturers' wholesale branches; only 11.3 per cent was marketed through independent retailers. Producers of mechanical refrigerators sold 96.7 per cent of their output to wholesalers and manufacturers' sales branches; only 1.2 per cent was sold directly to retailers.

The manufacturers of motorcycles and bicycles distributed, during 1929, 48.9 per cent of their sales through independent retail concerns, 37.4 per cent through wholesale firms, and 13.7 per cent directly to industries and large consumers who bought at wholesale prices. Four-

teen per cent of the above agents, selling agents, broke of ammunition and related through independent whole and other large consumers. was disposed of through manufacturers' and commission houses. Manufacturers products sold 81.8 per cent of their goods rs, and 15.8 per cent direct to industrial Manufacturers of sporting and athletic

MANUFACTURERS
OF AUTOMOBILE TIRES
COMPANY AND PRIVATE BRANDS

2 Mail order houses	25 Oil co. accts.	1,200 Job- bers	275 Mfrs. bran- ches	950 Ware- house dealers	1,350 Tire co. stores	2 Auto supply chains
900 Re- tail stores	1,500 Distri- bution points		84,000 Dealers, of which 14,000 consignment			375 Re- tail stores
	40,000 Filling stations	20,000 Jobber sub- dealers		35,000 Dealer sub- dealers		
Manufacturers producing 2,750,000 cars and trucks		Consumers using 20,600,000 passenger cars and 3,225,000 trucks and buses, except				Mileage and rental comm. and natl. and govt. accts.

CHART XII.—Tire outlets in the United States, 1934.¹

goods sold 70.3 per cent of their products to wholesalers and to their own wholesale branches, 21.5 per cent to retailers, and 7 per cent to industrial and other large consumers.

Chart XII indicates the methods of marketing tires in the United States in 1934. The manufacturers of cars and trucks buy their tires for original equipment directly from the tire manufacturers. This is a

¹ HOLT, E. G., "Tire Distribution and Retail Outlets in the U.S. in 1934," Bureau of Foreign and Domestic Commerce. Published in *Domestic Commerce*, Dec. 30, 1934.

large-scale demand which fluctuates directly with the demand for new automobiles and trucks. The firms that rent cars to others, and bus, truck, and taxicab companies, as well as governmental agencies, also buy their tires directly from the manufacturers.

The ultimate consumer who owns his own automobile and many small-scale owners of passenger cars, trucks, and busses buy indirectly, i.e., from the various kinds of retailers. The chart indicates in a simple manner the marketing structure built up to satisfy this small-scale but large-volume demand. The consumer may buy his tires from one of the 900 retail stores owned by the mail-order houses, or from one of the 40,000 filling stations owned by the oil companies, or from one of the 20,000 jobber sub-dealers, or from the jobbers themselves; or from one of the 84,000 dealers or one of the 35,000 sub-dealers; or from one of the 1,350 tire company stores; or, finally, from one of the 375 retail stores of the automobile supply chains.

According to the estimates of Colonel Ayres, the individual consumer buys 43.3 per cent of all manufactured goods, and the business firms buy 56.7 per cent; the individual consumer, however, buys only 28.6 per cent of all durable manufactured goods, while the business firms buy 71.4 per cent of such goods. The individual consumer, on the other hand, buys 73.6 per cent of the non-durable manufactured goods, and the business firms buy 26.4 per cent of this class of goods. These estimates are based on the 1929 Census figures. The proportion of manufactured goods bought by the individual consumer was, no doubt, greater during the depression period than those indicated above. Colonel Ayres uses the figures to support his thesis that the decline in the purchase of durable goods by business enterprises was chiefly responsible for causing depression unemployment. He contends further that the changes in the volume of buying by business are actuated by changes in the prospect for profits. Individual consumers change the volume of their purchases when their incomes have been increased or decreased by the increased or decreased payments made by business in the form of wages and other forms of cash distribution.

The Cost of Marketing Manufactured Goods.—Generally speaking, the costs of marketing consumer goods are greater than those for industrial goods. A casual inspection of Tables 73 and 74 discloses this fact. There is a considerable variation in marketing costs among the different products in each group. Thus the selling costs for machinery and machine tools, as reported by thirty-five firms, was 25.83 per cent of net sales in 1931, while the costs of marketing textiles to industrial users was only 9.15 per cent for the eleven firms reporting. The selling costs for building materials and supplies was 23.68 per cent. The sales department costs for each group in the industrial goods field accounted for

approximately 50 per cent or more of the total marketing costs. The electrical equipment and supplies group spent the largest percentage for advertising. Transportation costs were substantial for the chemical and allied products and the paper and paper products groups. "All other costs" were large for the building materials, iron and steel, non-ferrous metals, and the stone, clay, and glass products groups. The footnote-references in the tables indicate the items included in this classification.

TABLE 73.—COSTS OF MARKETING INDUSTRIAL GOODS
Actual, 1931¹

Industry	Per cent of net sales							
	Number of firms reporting	Total marketing costs ²	Sales department ³	Advertising and sales promotion ⁴	Transportation costs ⁵	Warehousing and storage ⁶	Credits and collections ⁷	All other costs ⁸
Building materials and supplies.....	17	23.68	11.77	2.95	1.61	0.76	1.00	5.89
Chemicals and allied products.....	6	19.87	10.56	1.22	3.33	0.65	1.25	2.86
Electrical equipment and supplies.....	14	19.77	11.99	3.04	1.81	0.12	0.68	2.13
Iron and steel and their products.....	20	18.95	8.97	1.89	1.30	0.61	0.69	5.49
Machinery and machine tools.....	35	25.83	14.61	4.38	1.03	0.78	1.23	3.80
Nonferrous metals.....	6	18.48	10.20	1.07	1.94	0.46	0.80	4.01
Paper and paper products.....	20	20.41	9.42	2.52	2.54	1.08	0.80	4.05
Stone, clay, and glass products.....	12	21.74	10.04	3.05	1.38	1.34	0.81	5.12
Textiles.....	11	9.15	5.10	1.26	0.60	0.15	0.64	1.40
Transportation equipment.....	10	15.50	8.76	1.67	1.36	0.74	0.65	2.32

¹ Adapted from "An Analysis of the Distribution Costs of 312 Manufacturers"; Association of National Advertisers, Inc., 1933.

² Includes salesmen's salaries, bonuses, and commissions; traveling expenses; sales office expenses; and all others.

³ Includes expenditures in advertising media; salaries and office expenses; samples, including cost of distributing.

⁴ Includes all transportation costs.

⁵ Includes all warehousing and storage costs.

⁶ Includes expenses of maintaining collection department, legal fees, credit service; losses from bad debts.

⁷ Includes financial expenses, and cash discounts on sales; general administrative expenses, prorated to selling and distribution; and all other distribution costs.

Total selling costs for paints and varnishes were the highest reported for the consumer goods group, *viz.*, 38.61 per cent of net sales. The lowest cost reported was 16.54 per cent for radio equipment and supplies. A larger percentage of total marketing costs goes for advertising in marketing consumer goods than is the case for industrial goods. The drug and toilet articles manufacturers spend 18.36 per cent of net sales for advertising and only 11.31 per cent for the sales department; "all other costs" account for 4.65 per cent of net sales. The manufacturers

of tobacco products, paints and varnishes, and heating equipment spend from 7.52 to 8.23 per cent of net sales for advertising. Transportation costs are high for agricultural equipment and supplies, confections and bottled beverages, and grocery products. Warehousing costs are important for petroleum products, and furniture; credit and collection costs are relatively high for jewelry and silverware manufacturers. "All other costs" are also high for this group, as well as for several other manufacturers listed in the table.

TABLE 74.—COSTS OF MARKETING CONSUMER GOODS
Actual, 1931¹

Industry	Number of firms	Per cent of net sales						
		Advertising and sales promotion	Transportation costs ⁴	Warehousing costs ⁵	Credit and collection costs ⁶	All other costs ⁷	Total	
Agricultural equipment and supplies	7	18.39	8.24	1.58	4.32	0.42	1.29	3.54
Automotive.....	10	24.68	12.85	3.99	2.37	0.58	1.60	3.29
Clothing.....	12	22.63	11.15	3.67	0.54	0.54	1.45	5.28
Confections and bottled beverages..	7	31.55	11.47	6.68	5.13	1.63	1.63	5.01
Drugs and toilet articles.....	14	38.80	11.31	18.36	2.54	1.14	0.80	4.65
Furniture.....	4	33.08	14.83	6.11	1.06	3.99	2.52	4.87
Grocery products.....	9	27.11	11.08	6.21	5.19	0.87	0.63	3.18
Hardware.....	9	18.94	9.07	2.16	1.16	0.74	0.84	4.97
Heating equipment.....	8	32.93	15.78	7.90	1.69	1.42	0.88	5.26
Home furnishings.....	14	21.69	12.35	2.94	0.90	1.05	1.21	3.24
Household appliances.....	10	26.45	12.75	6.83	0.87	0.50	0.63	4.87
Jewelry and silverware.....	5	28.66	11.54	6.29	0.31	0.46	3.51	6.56
Office equipment and supplies.....	9	32.15	21.26	3.23	1.46	1.55	1.33	3.32
Paints and varnishes.....	9	38.61	17.11	7.52	3.20	2.26	2.69	5.33
Petroleum products.....	4	31.04	10.89	5.98	3.50	4.29	0.86	5.52
Radio equipment and supplies.....	6	16.54	5.38	5.33	0.57	0.78	1.17	3.31
Shoes.....	7	21.19	8.72	3.67	1.83	0.85	1.83	4.79
Sporting goods.....	5	18.21	8.37	3.64	0.61	1.35	0.92	3.32
Tobacco products.....	4	18.27	3.23	8.23	0.70	0.34	0.72	5.05

¹ *Ibid.*

² Includes salesmen's salaries, bonuses, and commissions; traveling expenses; sales office expenses; and all others.

³ Includes expenditures in advertising media; salaries and office expenses; samples, including cost of distributing.

⁴ Includes all transportation costs.

⁵ Includes all warehousing and storage costs.

⁶ Includes expenses of maintaining collection department, legal fees, credit service; losses from bad debts.

⁷ Includes financial expenses, and cash discounts on sales; general administrative expenses, prorated to selling and distribution; and all other distribution costs.

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Questions for Discussion

1. Compare and contrast the general problems met in marketing manufactured products and (a) agricultural products; (b) natural products.

2. What is the distinction between industrial manufactured goods and consumer manufactured goods? How is the demand for each affected by the degree of durability?

3. "The demand for semi-manufactured goods is somewhat like the demand for raw materials, yet in some important phases it is distinctly different." What are the differences? How do you account for them?

4. "As in the agricultural market, so in the manufacturers' market, there are middlemen who perform all of these functions, and there are agencies highly specialized in the performance of one function or of a part of one." Give examples of each kind of middleman.

5. What is the effect of large-scale production upon the marketing problem connected with manufactured products?

6. "The essential undertaking in the marketing of equipment and supplies is the providing of equipment to meet some detailed and specific need." How does this condition influence the marketing practice? How do the problems of the producer who manufactures to order differ from those of the one who manufactures a standard line of products?

7. "Partly finished goods often pass directly from one manufacturer to another, although brokers or wholesalers may intervene." How do you account for the different practices?

8. "The importance of the machinery dealer may be emphasized as reflecting the need of representatives carrying stocks and furnishing immediate delivery service to the customer." Is this an important function? What other services does this functionary perform? How do these services differ from those performed by the manufacturer's agent?

9. "Manufacturers who sell through jobbers, mill supply houses, and agents have long been dissatisfied with results." Why? "The jobber holds a strong position in the plumbing, steam, and electrical construction supplies field, handling as much as 95 per cent of the business but only 10 to 15 per cent of finished steel." How do you account for this situation? What is the chief objection to the use of the manufacturer's agent?

10. Consult ten representative advertisements in some industrial magazine, and determine the leading appeals used. What do you think is the major purpose of each advertisement?

11. "Very commonly, merchandise, such as staple groceries, dry goods, and hardware, passes through the hands of a broker, selling agent, or buying agent, before it reaches the wholesaler." Why these particular agencies?

12. "The large meat packers and farm implement manufacturers commonly have their own branch houses and sell to the retailers through these branches." Why, rather than follow the orthodox route?

13. "There is nothing in the marketing of manufactured products to compare with the growers' local market." Of what significance is this condition?

14. How do you account for the use of so many different channels of distribution in the marketing of tires? What has been the effect on the price structure?

15. Why are the costs of marketing consumer manufactured goods generally higher than the cost of marketing industrial manufactured goods?

Assignment

Using the outline given in Chap. IX as a guide, prepare a report of approximately 2,500 words on the marketing of some manufactured product such as one of the following: beef, pork, ice cream, shoes, hats, men's suits, women's ready-to-wear, fur coats, millinery, manufactured tobacco products, automobiles, tires, batteries, furniture, radios, silverware, kitchenware, rugs, books, selected grocery, drug, hardware, or dry-goods items, bread, electrical washing machines, irons, vacuum cleaners, tractors, binders, cultivators, cream separators, milking machines, paper, flour, road building machinery, office furniture, office machinery, industrial equipment, steel, cement excavating machinery, milling machinery, machine tools.

1. Problem 4, p. 276. Neyer Tool Company.

2. Problem 1, p. 253. National Rock Drill Company—Characteristics of the Industrial Market.

3. Problem 2, p. 282. Richwell Supply Company—Selected Distribution.

4. Problem 1, p. 287. Cathron Company—Manufacturers' Agents.
5. Problem 1, p. 295. Tuxbury Chain Company—Direct Sale.
6. Problem 1, p. 304. United Shoe Machinery Corporation—Lease System.
7. Problem 1, p. 179. Indian Motorcycle Company.
8. Problem 1, p. 205. Raeburn Electric Company.
9. Problem 2, p. 208. International Paper Company.
10. Problem 2, p. 222. Kishiqua Plow Company.
11. Problem 1, p. 266. Strength Union Company.

CHAPTER XIV

THE MARKETING OF SERVICES

Purpose of this chapter: To indicate the economic significance of services; to classify the different forms of services on the basis of source or origin, and to determine their distinguishing features; and to analyze the major problems encountered in marketing the different kinds of services.

No reliable figures are available showing the value of all services consumed annually in the United States. According to the 1930 Census, about 25.1 per cent of the gainfully employed male population was engaged in agriculture; 24.1 per cent in manufacturing; 13.4 per cent in the wholesale and retail trades; 9.4 per cent in transportation; 8 per cent in the building and allied trades; 3.3 per cent in mining, forestry, and fishing; and 16.7 per cent in miscellaneous activities. There were, in 1929, almost 50,000,000 gainfully employed people in the country; each of these people was producing and selling his personal services in some form to some other person or organization. There were, in addition, other millions of people producing services for which they received no compensation in the form of wages or salaries. They did, however, receive compensation in the form of food, clothing, shelter, and home and family relationships. According to some estimates, one half of the gainfully employed are engaged in producing tangible goods, while the other half are engaged in producing: (1) professional and personal services, and (2) services more or less related to the production, marketing, and use of tangible goods. There is a large variety of services, non-personal in character, consumed by individuals, institutions, and business and non-business organizations. The following classification of services gives a fairly good idea of the variety and pervasiveness of this non-durable and highly perishable economic good.

A CLASSIFICATION OF SERVICES

1. Human:

- a. Labor: skilled and unskilled; factory, domestic, office, miscellaneous.
- b. Personal, such as those secured in barber shops, beauty parlors, hand laundries, shoe-shine parlors, and those given by photographers and funeral directors.
- c. Professional, entrepreneurial, and administrative, as given by physicians, dentists, lawyers, clergymen, teachers, writers, musicians, actors and other entertainers, engineers, journalists, nurses, accountants, brokers, architects, research men, business managers, and others.

- d. Miscellaneous, such as furnished by salesmen, appraisers, auctioneers, press agents, etc.
2. Mechanical, chemical, and electrical:
 - a. Transportation, as furnished by railroads, steamships, airships, busses, trucks, pipe lines, high-tension lines, etc.
 - b. Communication, as furnished by telephone and telegraph companies, and broadcasting firms.
 - c. Printing, services of preparing books, booklets, pamphlets, papers, magazines, folders, catalogues, etc.
 - d. Cleaning, as furnished by laundries, dry cleaners, renovators, etc.
 - e. Repair services.
3. Financial:
 - a. Credit as sold by banks; commercial and investment houses; loan companies; individuals; underwriting syndicates; investment trusts, etc.
 - b. Insurance, for example, property, marine, liability, life, accident, health, use and occupancy insurance.
4. Institutional:
 - a. Educational services furnished by kindergartens; graded, high, and vocational schools; colleges and universities, and other educational institutions.
 - b. News distributed by newspapers, magazines, etc.
 - c. Health and recreational, such as furnished by hospitals, sanitariums, parks, social centers, theaters, musical organizations, broadcasting companies, motion-picture firms, athletics, and sports.
 - d. Social and moral agencies, clubs, fraternal societies, religious organizations.
 - e. Charity: various organizations for helping the poor and needy.
5. Land, housing, and storage, as exemplified in the rental of:
 - a. Farms, houses, flats, and apartments.
 - b. Hotel rooms and suites.
 - c. Office, store, factory, and warehouse space.
6. Services sold with merchandise.

There is a certain amount of services sold more or less incidentally with merchandise. Some buyers erroneously believe these services are free; their cost, however, is usually included in the price paid for the material goods bought. Some of the commonly known services are delivery services furnished by retailers, the granting of credit, repair service, alterations, installations, demonstration, and teaching the buyer how to use or operate the machine or article purchased.

7. Government services.

Federal, state, and municipal governments perform many services which tend to "promote our peace, security, comfort, health, and well-being." The services performed by the post-office department, departments of commerce, agriculture, war, navy, and interior, and the public school system, for instance, are fairly well known. Since 1933 the services rendered by the federal government, especially, have been greatly extended.

This list of services is not intended to be all-inclusive; rather, it is given to illustrate the pervasive character and the extensive variations within this group. A casual observation of this list suggests many differences in the character of the diverse services, variations in the nature of the demand, and, as a result, necessary differences in the marketing procedure.

The 1933 Census of Service Establishments.—The first Census of Service Establishments, Places of Amusement, and Hotels in the United States reported a volume of business amounting to \$2,760,881,000 in 1933.¹ There were more than 500,000 establishments which employed in excess of 657,000 workers and paid them \$702,000,000. This census was quite limited and did not include many important producers and sellers of services. Certain forms of personal, business, and miscellaneous service establishments, some of the more important forms of amusement establishments, including theaters, and hotels were surveyed. Another classification, "all others," included sixty-seven classifications, some of which are athletic fields, bathing beaches, airports, race tracks, riding academies, laundry agencies, broadcasting stations, freight forwarders, bicycle repair shops, musical instrument repair shops, and a number of other repair shops. The reported volume of business for this group, which is admittedly not complete, was in excess of \$21,000,000.

The census did not include many dispensers of services whose volume of business, no doubt, far exceeded that reported. Thus such service establishments as transportation companies, power laundries, public utilities, boarding houses, educational institutions, financial institutions, insurance companies, and real estate agencies were not included. The census did not include the services performed by doctors, lawyers, dentists, and other professional groups; nor were the services of wholesale and retail employees included.²

Chart XIII, prepared by *Domestic Commerce* from census figures, indicates the relative importance of the various kinds of services—of those included in the census survey. The geographical location of these service establishments bears a close relationship to urban population and the amount of the per capita income. More than 50 per cent of the total business of service establishments of the country is concentrated in the five states of New York, Illinois, California, Pennsylvania, and Ohio. These same states account for less than 43 per cent of the total retail business of the country. If we include five other states—Massachusetts, New Jersey, Michigan, Texas, and Missouri—we have the

¹ The American people spend approximately \$5,000,000,000 in a normal year in holiday and vacation travel; about \$1,500,000,000 of this amount is spent in retail stores catering to tourists. The annual cost of recreation equaled about \$7,300,000,000 in 1933.

² The remuneration of people engaged in retailing plus interest and profits amounted to \$13,750,000,000 in 1929; the corresponding costs for wholesaling were almost \$7,000,000,000; and the marketing costs of manufacturers equaled \$3,640,000,000. The total number of people employed in marketing activities by retailers, wholesalers, and manufacturers in 1929 was estimated at 8,100,000, and the number employed in furnishing transportation and communication services at 4,400,000. Galbraith and Black, *Quarterly Journal of Economics*, pp. 394ff., May, 1935.

ten states that account for more than two-thirds of the total volume of services reported, yet these states contain only about one-half the population of the country. These same states account for 70.6 per cent of the receipts of service establishments, 69.1 per cent of the amusement receipts, and 63.9 per cent of the total receipts. Expenditures for services ranged from an average of \$2.81 per capita in Mississippi to a maximum of \$33.89 per capita in the state of New York. The average per capita expenditure for the country was \$14.05. Only nine states and the District of Columbia had per capita averages in excess of the average for the nation.¹

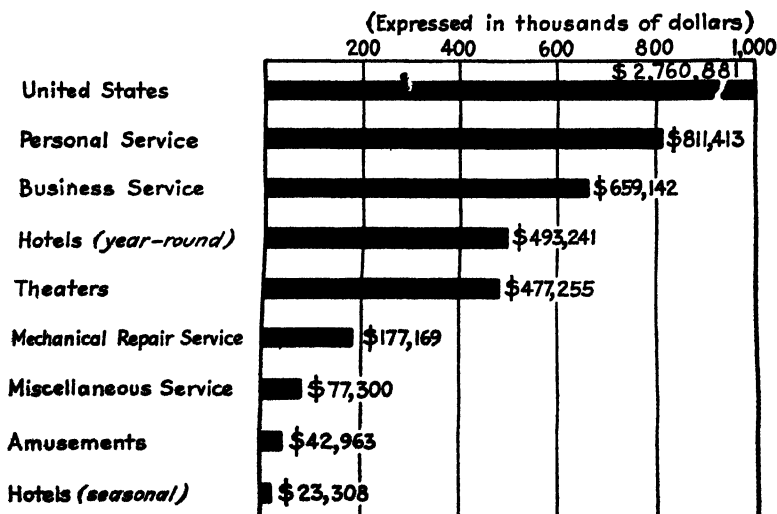


CHART XIII.—Receipts of service establishments, places of amusement, and hotels for the United States, 1933. (Prepared by Domestic Commerce from final figures published by the Census Bureau on the Census of American Business, 1933.)

General Characteristics of Services.—The practices followed in marketing a number of services are highly specialized. The problems encountered in selling or buying services derived from such tangible goods as apartment buildings and farms, for instance, are quite different from those met in marketing such services as are sold by insurance companies and bond houses. Despite all these individual differences in the products, the demand, and the marketing procedure, the general principles of marketing tangible products apply to a remarkable degree. It should be kept in mind that one of the primary motives for buying tangible goods is to secure the *services* which possession and ownership of the object affords. A person may buy or rent a house, automobile,

¹ *Domestic Commerce*, Dec. 30, 1934. Quoting from a report by W. A. Ruff, who was in charge of the survey.

and many other tangible goods, and an industrial or commercial firm may buy or lease certain machines for production purposes. The utilitarian services secured in either case are little different. Those who rent or lease, however, do not enjoy the satisfaction that arises from "pride of ownership"; and much of the control over the use of the article that goes with the title is absent.

One of the outstanding characteristics of services as a marketable commodity is the high degree of perishability. The time element is all-important. Services or potential services not utilized daily are economic losses. A building unoccupied, credit not utilized, the idle laborer, the professional man without a case, and the ship or warehouse loaded to only half its capacity are illustrations that suggest the perishable nature of this good.

Those services produced by mechanical agencies may be standardized; those produced by individuals may be standardized and graded only to a limited extent. Some of these services take on the characteristics of a monopolistic good. Thus the services of a famous musician, physician, athlete, philosopher, executive, or lawyer cannot be secured from any source other than the one individual capable of producing the particular service. The buyer, as is the case in the purchase of many tangible goods, frequently is not in a position to judge the value of the product, e.g., educational, medical, legal, investment, recreational, and many other services.

The value of a service may, and often does, depend upon the mental state of the purchaser at the time of consumption. An evening's entertainment at the theater, for example, may be ruined because of some adverse mental state that arises wholly independent of the play. The service purchased, on the other hand, may affect, and, in fact, even radically change the mental state of the individual. The price which a given service can command at any given time is governed by the same principles of supply and demand that control the prices of tangible commodities.

The owner of merchandise may be able to influence supply through storage; the producer of services does not have this recourse. The sales-promotion activities used in marketing some services are quite similar to those used in marketing tangible goods, although the methods used in marketing others are different. Some of the distinctive as well as the common features are indicated in the following analysis and discussion.

Marketing Human Services.—The importance of human services in our economic life is indicated by the amount of money paid for them. The amount paid out during 1929 in the form of wages amounted to \$34,149,000,000; the amount paid out as salaries equaled \$18,484,000,000.

These figures do not include payments for personal services in the form of fees, such as independent professional people receive. Wages and salaries account for about two thirds of the total national income *paid out*. They accounted for 80 per cent of the national income *produced* in 1932. Much of the effort of the New Deal legislation was directed toward increasing the proportion of the national income received by labor. Regulations establishing minimum pay and maximum hours of work were established.

Personal service is one of the most perishable of perishable commodities. Human services cannot be separated from the individual. The demand is small-scale on the part of consumers, and large-scale on the part of large industrial and commercial enterprises. The short-run demand for personal services is relatively inelastic. When labor is scarce and wages are high there is a tendency for entrepreneurs to substitute power and machines. Recent emphasis on efficient production and scientific management has tended to increase this substitution, thus displacing labor in a number of industrial lines. It is true, however, that the demand for human services in many other enterprises has been increased at the same time. A large portion of the demand for labor is a derived demand, that is, it depends upon the demand for the goods and services produced by the organization employing the laborers. When automobiles, radios, shoes, textiles, building materials, and other consumer and industrial goods are being sold in large quantities there is a large and steady demand for labor, unemployment is at a minimum, and wages are likely to be fairly satisfactory.

Marketing Labor.—There is usually a surplus of unskilled labor, while the demand for many lines of skilled labor is greater than the supply. Within certain definite limits the supply of labor is elastic. If wages are increased, some unemployed and part-time workers make their services available. A general shifting of labor from one industry to another occurs if one raises its wage scale above a parity with the others. The worker usually considers the relative desirability of the work, labor policy of the firm, location of the place of work, and other important factors before making the change. Beyond rather definite limits, however, the supply is highly inelastic due to the number of years required for children to grow to maturity, and the incentives necessary to bring about an increase in population. The restrictions on immigration tend to limit supply in this country.

* The laborer finds himself under a considerable handicap when he attempts to sell his services. His product is perishable and is produced only when sold; it cannot be produced during unemployment periods, stored, and sold when a demand materializes; consequently, an idle day is so much loss. Since the laborer's services have such a strong

personal character, the quality depends upon the age, health, skill, strength, and general well-being of the individual. If he is ill or suffers an accident he may lose his job; in most instances his pay ceases. As old age approaches, demand for his services declines. He is placed in an unequal bargaining position because of these factors. The employer's very existence does not depend upon his employing any particular individual; consequently, he can "shop around" or select from a large number of unemployed who are competing with each other for the limited number of opportunities to produce the services. To overcome some of these disadvantages a few classes of laborers have organized unions—such as are found among the building trades, in the textile industry, and among railway workers and the coal miners—which provide a means for collective bargaining. Some of the trade unions have been brought together under the direction of the American Federation of Labor. This organization has done much to secure the passage of state and national laws that have improved the laborer's economic status. Legislation enacted during 1933–1935 greatly encouraged the formation of unions.¹

The major portion of labor is marketed directly; contact is made by the laborer applying for a job, and by the prospective employer inserting advertisements in newspapers and posting notices at factory gates. Employment offices, some privately operated for a fee and others operated by the state at no direct cost to the laborer, provide a valuable service in helping the unemployed to find a job and in providing the employer with a means for locating desirable and qualified workers.

Professional Services.—The services of the professional groups are more highly individualistic even than those of the labor group. People demand the services of a particular physician, dentist, lawyer, accountant, executive, research man, or architect because of the reputation that individual has secured from successful practice. Another may be as good or better, yet the consumer will hesitate to trust his life or an important business problem to an unknown practitioner. The state regards the services of many of these professions as so vital to the welfare of society that laws have been passed regulating the entrance into them. Thus the physician, dentist, lawyer, and teacher, for instance, must secure a license. This procedure usually involves passing a searching examination, together with the presentation of evidence that the applicant is fit in every way to perform the services under consideration.

These professions have, in several instances, set up codes of ethics, which further restrict the freedom of operation. The medical profession,

¹ The Wagner Law enacted in August, 1935, and the Social Security Law enacted during the same month are designed to improve the economic and social positions of the laborer.

for instance, frowns upon the use of advertising and personal solicitation in promoting the sale of its services. The lawyer secures much publicity through the newspaper reports of the cases he pleads. He is not expected, however, to engage in "ambulance chasing" in an effort to increase his business. Professional men secure much of their business through recommendation of friends, former clients and patients, hospitals, and educational institutions. Memberships in clubs, fraternal organizations, alumni associations, and churches are used as indirect methods of increasing one's clientele. The demand for the services of physicians and dentists has been increased through their advocating physical examination of school children, and by their encouraging periodical examinations of adults. The advertising of life insurance companies and tooth paste manufacturers has likewise tended to increase the demand for medical and dental services. Teachers and educational institutions sometimes use teachers' agencies as a means of bringing the teacher and prospective employer together. A brokerage fee of 5 per cent of the annual salary received is usually charged the teacher for this service by the agency.

Mechanical, Chemical, and Electrical Services.—This group of services, generally speaking, is produced on a large scale by large companies which have enormous fixed capital investments. A single railroad system may control property with a value in excess of a billion dollars; a public utility holding company may equal, or even exceed, this huge sum.¹ There are, of course, many smaller companies, yet large-scale operation is the characteristic feature. The public service corporations buy durable and non-durable goods, and use them, together with human services, to produce and sell light, heat, power, transportation, and communication services.

A large number of the services in this classification are produced by monopolies. Thus there is usually only one street railway system and only one telephone, gas, and electric light company in a city.² The rates (prices) which these monopolies and the railroads can charge for their services are determined by certain governmental agencies, such as the Interstate Commerce Commission and the various state public utility commissions. These industries attempt to develop a larger demand for their services by both direct and indirect means. Railroads, for example, present their appeals to shippers and to passengers

¹ The electric power and light industry of this country is commonly referred to as a \$12,000,000,000 industry.

² Such industries furnish an excellent illustration of the importance of the price of the product in increasing consumption. Special rates, for instance, are allowed for home heating and industrial purposes by gas companies. Some street car companies sell a weekly "pass" for \$1 which gives unlimited personal transportation service to the bearer.

for their patronage by means of direct-mail and personal solicitation, and through newspaper, magazine, and radio advertising. Excursion and special trains are run at reduced rates or with more elaborate services. Some railroads feature their club-, observation-, and dining-car equipment; maid, valet, and telephone service, convenient location of terminal stations, level roadbed, and comfortable sleeping facilities. The pleasure of traveling in air-conditioned, streamlined, high-speed trains is emphasized. Freight tonnage has been increased through aiding the development of industry throughout the territory served by a railroad. Thus agriculture and dairying have been promoted through the use of the demonstration car and special lectures. Much of the land in the west was settled under the guidance of the railroads, and special rates are allowed the products of new industries just securing a foothold so as to permit them to reach a given market. The purpose in all these instances is to develop volume tonnage, so that the transportation company can eventually sell its service at a profit.

The importance of the transportation service is indicated by the following figures: motor-truck traffic in 1934 was in excess of 16,000,000,000 ton-miles, and steam railroad freight exceeded 27,000,000,000 ton-miles. Pipe-line carriage rose to 33,132,000,000 in 1934. Omnibus passenger-miles equaled almost 12,400,000,000, while steam railway passenger-miles rose to 18,000,000,000. Electric lines and airplanes perform an appreciable additional volume of passenger, express, and freight service.¹

Electric power companies have likewise been active in aiding the development of local industry and in selling household electrical appliances so as to increase the industrial and domestic consumption of electricity. Some have been severely criticized by independent appliance dealers because they sold the appliances at a lower price than the independents thought reasonable.

Selling Radio Services.—Broadcasting companies were developed in the beginning by those interested in selling radio parts. The stage of development has now been reached where more firms and interests want to establish stations than can be operated successfully over the limited number of wave-length channels available. This has necessitated governmental control over the establishment and operation of these facilities. This service is utilized largely by local and national advertisers who virtually buy the use of the broadcasting facilities and the right to present their program to the audience of the particular station. The station, in order to build up an audience that will make its service wanted, uses a large amount of the available time in the cultivation of a clientele and in the establishment of prestige. Its major appeal

¹ *Barron's Weekly*, May 27, 1935.

to advertisers is, of course, the size and quality of the group of listeners it provides. The power of the station, its efficiency of operation, the extent of territory covered, the number of families with sets in the district, the quality of these sets, and the listening habits of the people are some of the factors that determine the value of the service of any broadcasting station. Some of these companies not only furnish the mechanical and electrical facilities, but also provide talent for preparing and presenting the programs. The latter involves assembling the entertainers, conducting the rehearsals, and directing the final presentation.

The big problem in buying or selling broadcasting services is the determination of the size and quality of the audience and the degree of appreciation on the part of the audience of the program offered. No station, however, can maintain a monopoly over the prospective listeners. There are usually so many programs available that the listener can tune out the one he does not like, and choose one from several that may more nearly suit his fancy.

Printing.—The services of the printer may be classed among the necessities in modern business life. The large volume of magazines, books, and advertising materials issued monthly testifies to the wide use made of this important service. Competition is keen, although a union among printers is of some value in preventing a complete demoralization of prices. Printers, in order to create a demand for their printing services, furnish other services. The great popularity of advertising in recent years has given them an opportunity. They write copy, prepare layouts, make up catalogues, folders, booklets, broadsides, and printed letters, and give advice with reference to art work, drawings, and other essential elements. The salesman selling printing should be well versed in advertising principles and practice as well as in the technical phases of printing.

Cleaning Services.—The demand for cleaning services grew rapidly from 1921 to 1930. There was, of course, a decline in sales during the depression. The increased activity of women outside the home, the rapidly increasing urban population, and larger money income enjoyed by the average family tended to transfer the washing and the cleaning of clothes and household linens from the home to the factory. The laundry now attends to the family wash, including the ironing, while the dry cleaner takes care of the suits, dresses, draperies, and rugs. The demand for these services has been cultivated largely through newspaper, radio, and poster-panel advertising. Mail and personal solicitations are also used. The truck drivers who call for and deliver the clothes have regular routes, and play an important part in securing and maintaining goodwill for the firm. Some very effective sales-promotion campaigns have been conducted by the laundry machinery manu-

facturers' association. The purpose was to develop a demand for the products of the members by increasing the desire for the services furnished by their machinery. Appeals were made on the bases of sanitation, convenience, more leisure time for more worth-while activities, less drudgery for the housewife, and the reasonable cost. The total receipts for work done by 5,115 laundries in 1933 amounted to \$295,261,-845; in 1931 the business done by 6,400 laundries was almost \$466,000,-000; and, in 1929, 6,776 did a business of \$541,158,197. The state of New York ranks first, Illinois second, and California third in the value of the services rendered. The total receipts of cleaning and dyeing establishments for services performed were \$93,243,535 in 1933, \$147,500,-000 in 1931, and \$201,250,000 in 1929—a decrease of 36.8 per cent and 26.7 per cent for each of the periods respectively.¹ Establishments numbering 3,580 employed an average of 43,641 people in 1933.

Financial Services.—One of the most important services in present-day industrial life is credit. In a primitive society little credit is available or needed. Trade is largely on the basis of barter. As society becomes more complex, commerce and industry are developed and the demand for credit and risk bearing becomes greater.²

In a society as complex as ours an elaborate organization is necessary to assemble efficiently the sources of credit and to disperse it among the firms and individuals desiring this service.³ Such financial institutions as commercial and investment banks, loan and finance companies, commercial paper and bond houses, underwriting syndicates, and investment trusts are fairly well known. The various types of credit instruments, such as secured and unsecured notes, many different kinds of bonds, and other evidences of credit, are more or less familiar.⁴

Large-scale production and distribution require large amounts of fixed and working capital. Few individuals have enough resources to finance the organization and operation of these gigantic enterprises. Millions of individuals, on the other hand, have savings in relatively small amounts which they do not care to utilize in their own businesses. They want an opportunity to turn these funds over to some one who can use them to advantage and who is willing to pay the owner for this service. Promoters, financiers, farmers, merchants, and other entrepreneurs desiring to exploit some natural resource, develop a patent

¹ *Census of Manufactures, 1934.*

² See Chap. XVI for additional information on the importance of credit in marketing.

³ Consult Moulton, H. G., *The Financial Organization of Society*, 3d ed., 1930.

⁴ Credit is granted on the basis of one or more of the following factors: character, income, property, and potentials; in the case of governments, gold, silver, natural resources, economic development, political and social stability, and general taxing power.

right, expand a successful going concern, or reorganize and revitalize a declining one, furnish a demand for the supply of funds indicated above. The seller of this service wants, above all, to be sure he will have his principal fund returned to him according to the contract; he wants the payments for the use of the credit made promptly and regularly. He may desire, in addition, to be able to secure the return of his money at any time he wishes. If the investor demands this feature, he will usually have to buy a security that is listed on one of the major security exchanges and one that is traded in every day. With such a security he can liquidate at any time. Whether he receives more or less than he paid depends upon the demand and supply for that particular class of security, the interest rate, general business conditions, and the financial situation and trade outlook for the particular firm at the given time.

Since credit is so closely connected with business transactions, the supply of credit and the demand for it tends to go up and down as business goes up and down. The business depression beginning with the stock market crash in 1929 culminated in the banking crash of 1933. Following 1933, the federal government has played an important part in the supply and control of credit. The demand increases with better business conditions. The government, however, is much more liberal than private enterprise in extending credit to individuals, business firms, banks, and others. Because of its control over money, and since it has such tremendous taxing power, the federal government can produce an amazing volume of credit and distribute it on both a wholesale and retail basis.

Selling Credit.—The demand for credit depends on the confidence the would-be borrower has in future economic and social conditions. If he thinks he can use the credit so as to earn a profit he may desire the loan. The sale of a large bond issue of an important company involves a vast amount of technical service.¹ Assume that the Block Manufacturing Company, a large industrial concern, wishes to secure \$25,000,000 of new capital through the sale of bonds.² The company might undertake to sell these securities directly to the ultimate buyers. The usual way, however, is to approach some large investment banking firm to determine what terms can be arranged. Assuming that the preliminary negotiations lead to a serious consideration of the proposition, the bank will conduct a thorough investigation of the industry to determine the

¹ Consult A. L. Bishop, *The Financing of Business Enterprises*, Chaps. XXI-XXV, for a discussion of the marketing of high-grade, low-grade, and worthless securities. See also H. G. Moulton, *op. cit.*

² The sale of securities is now closely regulated by federal and state laws.

present trend and future possibilities, the nature of the need for the product, and the competitive situation; it will carefully examine the organization, personnel, policies, manufacturing facilities, marketing methods, legal status, and other pertinent factors of the firm. The banking firm, in making this exhaustive analysis, will employ the services of experienced engineers, economists, lawyers, and accountants. With the facts secured by this corps of experts before them, the executives of the investment bank are in a position to decide whether they wish to sponsor the financing and to undertake the marketing of the securities, and, if so, upon what terms.

If these terms are acceptable to the officials of the industrial firm, the bank may undertake to sell these securities through its own organization. The usual practice, however, with a large issue, is for the bank to organize an underwriting syndicate comprising several other investment banks. This syndicate agrees to accept the bonds of the industrial firm and pay over to its management the amount agreed upon. The syndicate now begins the sale of the bonds by disposing of large blocks of them in wholesale lots to banks and bond houses throughout the country, and even in foreign countries. These organizations undertake the retailing of the securities to individuals and others. Many investment bankers sell to banks and insurance companies at wholesale, and to others at retail.

Newspaper and radio advertising, direct-mail solicitation, and personal salesmanship are used to consummate the sale of the securities. The margin between the price paid by the investor and the amount received by the industrial firm, which is required to pay for these marketing activities, depends largely upon the quality of the securities, the reputation of the firm issuing the bonds, and the condition of the money market. Thus the industrial firm might receive 88 from the underwriting syndicate, while the last purchaser would be required to pay 96 or 97 for a 5 per cent bond with a face value of one hundred dollars.¹

The larger and more reliable investment houses have a praiseworthy code of ethics. They are very conscientious in their recommendations, frequently provide an active market for the securities they have underwritten or distributed, watch the progress of the company, and take steps to protect the interests of the bondholders if the issuing company meets serious difficulty.

Such credit instruments as bonds are sold to national, state, and private banks, trust companies, loan companies, insurance companies of

¹ The Pennsylvania Railroad issued in January, 1936, \$40,000,000 general mortgage 3¾ per cent bonds. This issue was bought by Kuhn, Loeb & Co. at 96¾ and accrued interest and offered to the public at 98¾.

various types, corporations, colleges, religious and charitable institutions, estates, and private investors.¹

A large number of firms sell some of their securities to employees; public utilities and some industrial firms sell junior securities to their customers. The chief sales-promotion methods used in these cases are posters, mass meetings, recommendations of officials, newspaper advertising, and mail solicitation. Such inducements as partial-payment plans, a price below the market, and the firm paying part of the purchase price, are used effectively. This type of demand, however, has practically disappeared since 1930.

Insurance Services.—The demand for insurance services has grown by leaps and bounds during the last twenty-five years. As industrial and social life became more complex, the need for some device to shift risks became more and more pronounced. Insurance is a plan which provides for shifting the risk of certain kinds of losses from an individual or a firm to a group. It is the application of the principles of the distribution of risk and of indemnity. Through experience the probability of loss from certain causes has been fairly accurately determined so that equitable rates or prices for carrying these risks have been determined. There is a powerful sentimental appeal used in selling life insurance. The desire of the head of the family to make some provision for the material welfare of his dependents, should he pass on first, causes him to make great sacrifices to pay his insurance premiums. The sale of other forms of insurance is based on a more rational and materialistic form of appeal.

The method of selling this service is highly organized. The agency system is used extensively. Agents work on a commission basis, and many of them carefully select, train, and supervise their salesmen who are likewise paid on a commission basis. There is another side to the system which is not so satisfactory. Some agencies hire salesmen and send them out with very little training or supervision. This type of salesman sells, perhaps, to his immediate relatives and a few friends, and then his usefulness ends. He frequently becomes discouraged and quits. This practice tends to demoralize a portion of the market and discourage the regular full-time salesmen. Newspaper and magazine advertising, direct-mail solicitation, publicity, and posters, as well as personal solicitation, are used to sell this service. It is a strange situation that

¹ The importance of some of these sources of demand is indicated by the following figures: fifty-two American insurance companies held in excess of \$6,000,000,000 of securities on Jan. 1, 1930; the bond holdings of the reporting banks of the country June 30, 1929, were approximately \$17,000,000,000. One corporation held \$123,000,000 of United States Government obligations, and one university had investments in 1929 totaling \$81,833,142, of which more than 60 per cent was in bonds. *The Bond Business 1930*, Halsey, Stuart & Company.

although the need and advantages of insurance are well recognized a comparatively small amount is *bought*; the greater proportion is *sold*. The insurance companies sell insurance and use the premium payments to extend credit to others. The interest received from this form of service constitutes an important source of income for the insurance company.

Selling Education.—The demand for educational services in the United States is intense and widespread. Every state in the union has a compulsory school-attendance law. Each child between the ages of six or seven and fourteen to eighteen, depending upon the state, is required to attend the public or some other approved school. The elaborate system of publicly owned high schools and universities is supplemented by a large group of endowed institutions. There are, in addition to the schools owned and operated by the public, private schools, academies, seminaries, colleges, institutes, and other educational organizations, some of which are partially endowed, and others operated as a business enterprise for profit. The federal office of education estimated that the total expenditures for all education for the school year 1931-1932 were \$2,946,073,024. This one item, it will be noted, exceeds the total reported by the 1933 Census of Service Establishments. About \$10,000,000,000 is invested in school plants, and \$2,000,000,000 in endowments.

The state-owned and the endowed institutions of higher learning employ rather subtle methods of sales promotion. A more or less beautiful campus, and large and imposing buildings may be used effectively to create prestige and atmosphere. After a few years these buildings and grounds accumulate a store of tradition that is passed on, by word and song, in a most effective manner. Great emphasis is placed on developing school spirit and loyalty among the student and alumni bodies. The alumni are expected to be earnestly interested in securing new funds, brilliant students, and a few promising athletes. Some institutions have very large and aggressive alumni associations, with active branches located throughout the country and some in foreign lands. It is regarded as quite the proper thing for fathers and mothers to send their children to the same institution which they attended. Fraternities and sororities may be very influential in bringing new students to the college.

The catalogues and bulletins issued vary from a plain booklet giving necessary facts about the location, organization, faculty, admission requirements, courses offered, and fees charged, to elaborately prepared books with attractive and expensive pictures of buildings, grounds, and equipment, and of athletic and other student organizations. College yearbooks, magazines, and newspapers published by the student body, and technical and literary journals edited by the faculty also furnish

means of propaganda and publicity. The prestige and reputation of some educational institutions are greatly enhanced through operating university printing presses, experimental stations and farms, bureaus of business research, laboratories, clinics, hospitals, and radio stations.

The greatest amount of publicity is generally secured through the activity of the athletic teams. A winning football team, for example, will secure a tremendous amount of free space and favorable news stories in a large number of papers during a season. The glee clubs, bands, dramatic and debating organizations are valuable instruments for securing publicity for the school. Home-coming parades help to "sell the college to the city"; the "Junior Prom" attracts the attention of the society group; while athletic tournaments and other contests held for high-school students bring these young prospects to the campus where they can be "sold" on the advantages of the institution. The grand finale, the annual commencement, sends the graduates off with a flourish and helps to prevent those still in school from becoming discouraged, and at the same time encourages the parents to continue the necessary financial assistance.

The activity of the faculty is an important element in the scheme of publicity. The president is given and seeks many opportunities to make speeches in which he can dwell upon the high ideals, cultural atmosphere, and the scientific and professional training fostered at his institution. One of the major tasks of the president of a state institution is to sell, and to keep sold, the organization to the legislature, taxpayers, high-school principals, and prospective students. The faculty, through articles and books published, papers read at meetings of learned societies, and offices held in various organizations, aid in increasing the esteem in which their school is held. Scholarships are employed to encourage the attendance of deserving students.

A large number of schools, colleges, and universities use, in addition to the publicity secured, newspaper, magazine, and radio advertising. Direct-mail solicitation and in some instances personal solicitation are used effectively to secure students. Some educational institutions employ well-known advertising agencies to plan and prepare their advertising copy.

Amusements.—People want to be amused and entertained. Children want to go to the circus and to the zoos; young men and women want to dance under what to them are agreeable conditions and surroundings, and to attend theaters and movies featuring stories of love, romance, adventure, pathos, and famous historical events; the older group may prefer the opera, bridge, or travel. Many people secure pleasure and a certain degree of thrill from watching some contest, such as a horse race, automobile race, baseball game, or a prize fight. The natural

desire to be entertained apparently can be greatly stimulated through the use of suitable sales-promotion methods.

The motion-picture business has developed into the billion-dollar-industry class because its sponsors have successfully cultivated this desire. Practically every known sales-promotion device is employed. Large electric signs, beautifully and richly appointed theaters, posters and cutouts, and magazine, newspaper, and radio advertising are skillfully and effectively used.¹ The consumer is continually subjected, in addition, to a flow of publicity in the form of pictures, news items, and human-interest stories about directors, actors, actresses, the method of producing, and the subject matter of the pictures prepared by shrewd and highly paid press agents.

The modern talking motion picture done in color is an excellent example of the successful assembly, coordination, presentation, and marketing of a group of highly specialized services. Since 1926 there has been a rapid integration in the movie business. A very small number of companies now virtually dominate the industry through control of the theaters and all producing facilities, including contracts with leading actors and actresses. The marketing problems have been unusually difficult because of the rapid changes in basic technological factors. The problems arising from the introduction of the sound feature which created a virtual revolution in the industry had hardly been solved when the color feature appeared. There is constant fear in the industry that outstanding developments may suddenly appear and make necessary radical readjustments. Past experience indicates, however, that the leaders are capable of making rapid and effective adjustments to any situation that may arise. The American people spent \$935,371,000 for amusements and theater services in 1933; this was equal to about \$7.44 per capita.

Selling News and Advertising Space.—Newspapers received almost \$367,500,000 from subscriptions and sales, and almost \$570,000,000 from advertising in 1933; the corresponding figures for 1931 were \$425,250,000 and \$868,250,000. Periodicals other than newspapers received from subscriptions and sales in excess of \$239,000,000 in 1933, and \$261,500,000 in 1931; for 1933 they received in excess of \$428,500,000 for advertising, while in 1931 almost \$625,000,000 was received from advertising revenue.¹

Newspapers and magazines have enjoyed a remarkable growth in income since 1921. This resulted chiefly from the increasing use of

¹ One producer, Metro-Goldwyn-Mayer, is reported to have spent approximately \$3,000,000 during the fiscal year ending in the autumn of 1935 for poster, magazine, and newspaper advertising.

² 1933 Census of Manufactures.

advertising placed in these mediums. They derive an enormous revenue from selling "white space" to local and national advertisers. A single page in one of the leading weekly periodicals is reported to cost the advertiser from \$7,000 to \$14,000 for each insertion, depending on whether the advertisement is in black and white or in colors. It is obvious that the so-called white space is not in itself worth any such sum of money. The amount that a publisher can secure for his space depends upon the quantity and quality of his circulation. He sells, in fact, not white space, but an *opportunity* or a *means* by which the advertiser of some economic good may present a message about the product to prospective customers. The publisher's entire appeal in selling this service centers around an attempt to convince the advertiser or his agent that his particular publication possesses a select circulation, as far as quality and quantity are concerned, and meets the advertiser's needs in a very special way. The truthfulness of the publisher's claims as to volume of circulation is checked by the Audit Bureau of Circulation. There is no such impartial judge for the quality element.

Newspapers and magazines secure and hold their groups of readers—to whom the advertiser hopes to sell his product—largely through their editorial policies. Each publisher attempts to endow his publication with a certain distinctive personality. The make-up of the paper, the character of the editorials, and the manner of treating news items contribute much to this personality and individuality. A vigorous attitude on certain foreign and domestic policies and problems, alertness in being first when the "big news breaks," and reporting in an authoritative and reliable manner important political, civic, economic, and social happenings contribute to the prestige of a publication. One New York newspaper alone is reported to have increased its circulation 80,000 during the Hauptmann trial, due to the public's desire for this type of news. The stories were of the so-called "human-interest" type which appeals largely to the emotions. There were many more potential fundamental sources of news occurring at the time, which were crowded off the front page because the newspapers thought the events of the trial furnished better subject matter for "dramatic appeal."

Publishers of magazines and newspapers are able to give the readers more value than the subscription price warrants because of the revenue received from advertising. It is evident that a publisher sells two different products—*news* and *white space* or an *opportunity*—to two distinct markets, the reader and the advertiser.

Assembling News.—News has been defined as the timely record of significant local and foreign events, acts, or opinion. The marketing of news is a highly specialized task. This product is extremely perishable. What is news of the highest value in the morning may be stale or dead

by afternoon; speed in the collection, printing, and sale is of the greatest importance. It is assembled from all parts of the world by the fastest means known and available. The radio, cable, telegraph, telephone, wirephoto, and airplane, as well as automobile, express train, horse, and messenger, are used in the mad rush to secure and publish the latest news item. The vehicle of communication best suited to the circumstances is utilized. Cost is incidental, speed is supreme. Elaborate news-gathering organizations, such as the Associated Press and the United Press, have representatives stationed at strategic points throughout this country and in many foreign lands. These reporters, observers, and writers permit little of news value to escape them.

The sale of news is based on man's inherent curiosity, a desire to know what is "going on" or being said. He is interested in events and conditions that affect his health, wealth, and well-being. His inherent desire for approbation and applause causes him to attempt to get his name or picture in the paper, and then he buys the paper to see if it is in. Papers meet this demand by organizing such departments as the people's column, and foreign, domestic or local, political, social, sport, and financial news sections.

Methods of Marketing News.—Newspapers are sold direct from the publisher and through middlemen. There may be, and usually are, several editions of a city paper each day. These are usually sold in different ways. Some are sold only by newsboys on the corners; other editions may be sold by corner salesmen who are employed by the publisher, and by independent newsdealers; still other editions are distributed to the homes by carriers, boys who operate over well-defined routes in designated districts of the city; the same or possibly other editions will be mailed to out-of-town subscribers; and some will be sent by train, automobile and airplane to distributors in towns and cities, perhaps several hundred miles distant. These papers may be distributed by local carriers, who operate under the supervision of local directors, or sold on newsstands and in drugstores.

Many plans are used to secure, increase, and maintain a list of buyers. Newspaper and radio advertising, direct-mail and personal solicitation constitute a part of the sales-promotion activity. The offer of prizes to boys and girls who secure a certain number of subscriptions is very effective in increasing circulations. Contests among the carriers and newsboys to encourage them to secure new customers, and prizes and premiums are used as additional incentives. The paper may be delivered for a week free, as a sample, with the hope that it will be taken regularly afterwards. The presence of a newsboy on almost every corner in the downtown section, yelling "extra," the desire of people to know the "latest," and the wish to "pass away" the tedious time many people

have to spend on a street car, bus, or subway while traveling to and from work, all tend to make people willing buyers of newspapers and magazines.

Development of a Full Line of Service.—There seems to be a decided trend for service companies, as well as many producers of tangible commodities, to attempt to fill one basic human need rather than to produce only one particular product or service. Thus the Pennsylvania Railroad Company has ceased to be just a railroad and has become a general transportation system comprising bus, truck, airplane, and water transportation services as well as rail. The Radio Corporation of America, to cite another illustration, is now an amusement company rather than just a radio firm. The following quotation exemplifies this statement.¹

In the business primarily of supplying home amusement, the Radio Corporation of America combined with the Keith-Orpheum Theatre system, which supplies amusement at public places. And to make the thing more complete, they pulled in F.B.O. from the motion picture field. Later the Radio Corporation engineered a complete merger with another powerful amusement competitor, the Victor Talking Machine Company.

In addition to this, the company controls the National Broadcasting System, as well as R.C.A. Photophone, Inc., which is now producing its first talking pictures, challenging the system developed by the Western Electric Company.

This is not the end. At the present time, these people are going ahead with the development of a possible competitor for their own Photophone—another home amusement device which may be even more powerful than radio. Within eighteen months, possibly twelve, they will have developed a talkie projector for the home. And they are confident that within another twelve months, they will have a perfected instrument that will reproduce on a small screen set up beside the home radio set, a motion picture projected from a central broadcasting station.²

They are attempting to develop, for production in commercial quantities, still another home amusement device—a new music box which will probably be called the Theremin, after its inventor.

Governmental Services.—The cost of the services furnished by various forms of governmental units is roughly indicated by the tax bills of the country. The aggregate amount of taxes assessed for 1934 approximated \$9,500,000,000. If the ordinary budget had been balanced, an additional \$4,000,000,000 would have been required, or a total of \$13,500,000,000. These figures do not include emergency expenditures. The deficits were financed through borrowing. The

¹ Donn, A. E., "Changing Living Habits Mean Changing Distribution," *The Car Card*, p. 4, April, 1930.

² This prophecy was, obviously, too optimistic.

total debts of states, cities, and counties, at the beginning of 1935, was approximately \$20,200,000,000, compared with \$3,800,000,000 in 1912. If the ordinary budget had been balanced in 1933 through taxation, about 25 per cent of the national income would have been required. The cost of the federal government was \$734,000,000, or 1.6 per cent of the national income, in 1917; it was \$3,500,000,000, or 4.5 per cent of the national income, in 1926; by 1934 the cost had risen to \$7,100,000,000, which was 17.4 per cent of the national income.¹ The total federal tax receipts for the fiscal year ending in 1935 were \$3,297,300,578.60; income taxes alone for the year amounted to \$1,099,489,864.55. These figures clearly indicate the growing importance of the federal government as a service-producing agency.

There are, according to Professor Anderson, 175,418 local governments in the United States, *e.g.*, 127,000 school districts, 20,000 townships, 16,000 incorporated cities and villages, 3,000 counties, and 8,600 miscellaneous districts, park districts, levee districts, and similar units, each with power to levy and collect taxes and to spend the proceeds for labor, materials, equipment, supplies, and other purposes.

A considerable portion of the federal taxes goes for debt service, costs of the army, navy, and general administration; salaries of thousands of governmental employees, and, since 1932, for relief purposes. The various branches of government paid out, in the form of salaries during 1927, about \$4,972,000,000; the amount was much larger in 1935.

The type of services furnished by a large municipality and the cost are indicated by the following data published by the city controller.² The amount of the city tax for the year 1935 was estimated at approximately \$20,000,000; 39.1 per cent would pay for educational services; 27.8 per cent was for bond interest and retirement; 27.1 per cent was for general city purposes; 3.2 per cent for fire and police pensions; and 2.8 per cent for the sewerage fund.

The pervasiveness of services is well illustrated by the purchase and use of an automobile. A large proportion of the price paid for an automobile represents the cost of services. For example, the services of the miners who extracted the iron, copper, tin, zinc, and other metals, and the coal and other fuels used in the processing; the services of the transportation companies that carry the products—raw materials, partly manufactured, and the finished products; the services of finance, insurance, and other risk-bearing agencies; the services of workmen, office employees, and executives engaged in producing the car; the services of salesmen, advertising agencies, newspaper and magazine publishers; and the services of independent dealers who sell the product

¹ *Brookings Economist*, Jan. 2, 1935.

² Milwaukee, Wis.

to the ultimate consumer. The taxes paid to the federal and state governments on the car, and the sales tax paid on the gasoline and oil, help pay for hard-surface roads, police protection, administration, and other governmental services.

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Questions for Discussion

1. Compare and contrast the characteristic features of services, and the method of production with similar features of (a) agricultural products; (b) natural products; (c) manufactured products.
2. Are services consumer or industrial goods? Justify your answer.
3. Services are defined as comprising all intangible goods. Make a rather comprehensive list of all the services you can think of, stating your basis of classification.
4. "As services are intangible, they do not fall readily into the same grooves as material objects." What functions must be performed in marketing services? How do they differ from those performed in marketing material goods?
5. Give at least five illustrations of instances where and when services are marketed in connection with the sales of tangible goods. Under what conditions does this practice arise?
6. "There are certain semiprofessional groups which also offer services, and the less professional the occupation of the group, the better it appears to be organized for purposes of marketing." How do you account for this situation? "Many services are, of course, sold which are in no sense professional." Give illustrations and indicate how they are sold.
7. State in rather detailed form the methods used by the American Federation of Labor and its unions in marketing the services of organized labor.

8. "Most public utility corporations fall into the last class, that is of non-professional organisations which have nothing to sell but services." Cite other similar organisations. What special marketing problems do they encounter?

9. "Somewhat different strategy may be needed to reach each of the different classes" of customers of electric current. What are these different classes of customers? Why should the strategy of selling be different? How does price affect the sale of this service?

10. "Hotel marketing may be divided into outside and inside selling." How do these two activities differ? What methods should be used to obtain each objective? Classify hotels on the basis of the kind and class of customers to which they appeal. How do the policies and methods of selling the services differ in each instance? What are some of the possible major features that hotel managements may and do use to attract and hold customers? Consult J. O. Dahl, *Selling Public Hospitality*, and L. M. Boomer, *Hotel Management*.

11. What are the essential factors that determine the successful marketing of such highly specialized service as orchestra music, and the services of an individual director, singer, or player? Consult the autobiography of Rudy Vallee, and an article by M. Davis, "How We've Set Business to Music," *Nation's Business*, September, 1929.

12. "Personal salesmanship, periodical advertising, direct-mail advertising, and window display may be used in the sale of thrift." What are the characteristic features of this service; of the demand for it? How do these features affect the marketing practice?

13. A group of men have formed a corporation for the purpose of establishing and operating one of the following (a) a commercial bank; (b) a hotel; (c) a motion-picture theater; (d) a newspaper; (e) an advertising agency; (f) an insurance company; (g) a golf club; (h) a bus line. How could the corporation effectively sell the services implied in each case? Be specific in your answer.

14. Outline the possible methods of selling the services of each of the following professional men who are just starting independent practice. Give special attention to possible sales-promotion activities. (a) A young certified public accountant; (b) a young medical doctor; (c) a young doctor of dental surgery; (d) a young man with suitable training and practical experience starting his own advertising agency; (e) one starting as a lawyer; (f) a graduate of a collegiate school of business.

15. How does the nature of the product (services) affect (a) the *methods* of selling and of buying; (b) the *organization* for selling them?

PART IV

SOME FUNDAMENTAL MARKETING PROBLEMS



CHAPTER XV

SOME MARKETING PROBLEMS CONNECTED WITH PRICES

Purpose of this chapter: To analyze the significance of *price* in our economic and social life, and to determine and study some of the more important price policies and practices in their effect on marketing problems.

Present-day economic life is based on the practice of exchanging tangible goods and services for money or money equivalents. We have advanced a considerable distance, along the road of civilization since our more or less remote ancestors followed the practice of taking by force or stealth desirable goods found in the possession of other individuals or tribes. The simple practice of barter was a decided advance in ethical ideals and business judgment over the barbarous methods of might, stealth, and slavery. The barter system, however, is not suited to the needs of a complex industrial system. The major defects of this economic device are quite obvious. There was a demand for some suitable standard of value and an acceptable medium of exchange. The concept of money developed. Many different articles at different times have been used as money among various peoples throughout the world. Pastoral tribes typically used sheep and cattle, and hunting tribes often used furs and skins as money. Others have used as a medium of exchange such articles as slaves, grain, paper, salt, leather, tea, tobacco, iron, silver, gold, and copper. Various forms of credit instruments are being used as effective mediums of exchange in the leading industrial countries.

We now usually state the exchange value of an economic good in terms of some monetary unit. The exchange value of any given good is its "power to command other goods in exchange." When this is stated in terms of money we call it *price*. Thus we say, for example, "The price of this fountain pen is five dollars."

The Role of Price in Our Economic Organization.—One of the primary services of a marketing system is to provide a means for arriving at an exchange price through an economical adjustment of supply and demand.¹ The importance of price in present-day industrial society can hardly be overemphasized. Price controls the direction and the amount of the flow of productive energy; it directs the apportionment of

¹ The reader should bear in mind also that the supply of and the demand for goods at any given time may depend to a considerable extent on the price.

wealth. Relatively high prices for the product of one industry, for example, may produce great profits. In order to produce more goods so as to secure greater profits, entrepreneurs in the favored industry bid against each other and against producers in other industries for land, labor, capital, and management. They pay higher wages, rents, and salaries than the going rate, thus drawing the productive forces into the industry whose product is selling at the high price. The ultimate result tends to be that production is greatly increased. Then keen competition in selling arises among the entrepreneurs; prices are reduced; and, although more goods may be sold, profits tend to decline and may even disappear. The flow of productive energy is then deflected toward more profitable enterprises.

Prices also control the flow of wealth from the consumer to the producer. If prices are raised relatively too high, buyers may cease to purchase altogether, buy a smaller amount, or seek a substitute.¹ The rapid rise in the prices of pork and beef products during 1935 illustrates this condition. Prices exert their influence by determining the volume of sales; margins of profit; costs of production, marketing, financing, and risk-bearing; expenditure for labor; and the costs of living. They may determine what goods and services will be bought and the markets and methods utilized. Governments, institutions, investors, business executives, and workers evidently are vitally interested in price movements.

• *Price Ranges and Trends.*—The modern price system is extremely complicated and difficult to control.² There are general and specific price trends for individual commodities, such as steel, wheat, hogs, cotton, coal, and pig iron; there are price trends for groups of products, such as textiles, agricultural, non-agricultural, and food products; there are price trends for service groups, represented by such price series as wages, interest rates, rents, freight rates, and electric power rates. Wholesale and retail prices provide another widely used classification.³

Abrupt changes in the trend of general prices, that is, an abrupt change in the prices of a large number of widely used commodities and services, produce serious economic, social, and political problems. A sudden rise in general prices, we learned previously, greatly injures large groups of people who belong to the fixed-income and salaried groups. As the prices of commodities rise, the dollar declines in purchas-

¹ When the price of butter was greatly increased during the first half of 1935 sales declined. Thus the consumption of butter declined 46,000,000 pounds during the first five months of 1935 while the consumption of oleomargarine increased 77,000,000 pounds.

² We probably should also say that prices—their causes, effects, and movements—are extremely difficult to understand.

³ Refer again to Chart I, p. 42.

ing power. Thus a family which found its income of \$2,500 sufficient for the more pressing needs might find, as happened in 1918 to 1920, that its income would buy only half as much as formerly. The person who loans money during a period of low prices and is repaid during a period of high prices receives the same number of dollars as he gave, but the purchasing power of this money has been greatly reduced. A period of falling prices, such as occurred from 1929 to 1933, works against the interests of many producers and those whose income varies with profits. Falling prices therefore benefit the fixed-income and creditor classes, but are detrimental to the interests of producers and the debtor classes, while rising prices benefit the producers and landholders and others with *something* to sell, and injure those whose incomes do not expand with rising prices. A system that would bring about, in an equitable manner, a stabilization of prices would be a great social benefit.¹ The advocates of the so-called commodity dollar had this objective as their goal. A decline in prices, however, which results from increased efficiency in marketing and production is not objectionable; in fact, it may be highly desirable from both a social and an individual point of view.²

Price Relationships.—Prices are highly interdependent. The price of almost every commodity or service enters into or influences all other prices. There appears to be no beginning or end. If we start at any given place to trace the course of the given price, we soon branch out in all directions and eventually come back by a circuitous route to the starting point. The price of consumer goods, for instance, tends to include or reflect the cost of goods to the merchant, which includes the transportation, insurance, rent, labor, and other costs, together with the wholesale cost of the goods. The wholesale cost reflects the manufacturer's costs, which include labor, machinery, raw materials, interest, and depreciation costs. The raw material costs reflect the land, machinery, labor, and building costs of the producer of raw materials. Labor cost in all instances includes the cost of living—food, clothing, and shelter of the worker—which brings us back to the consumer goods bought from the retailer. If we take any element in the chain of prices and costs,

¹ The probable causes of these radical changes in the general price levels have been the subject of a great amount of serious discussion, much of it heated at times, among economists, statesmen, and business men throughout the world. It is rather generally accepted that these changes are due to (1) changes in the effective supply of (gold) money and credit; or (2) the quantity of commodities available for use; or (3) an increase or decrease in both. For detailed discussions of this interesting subject, consult any standard text on economics, especially the following: Alfred Marshall, Taussig, Seligman, and Ely, and the writings of Fisher, Edie, B. F. Anderson, and Ayers.

² Cf. Moulton, H. G., *Income and Economic Progress*.

we find the same complex situation repeated. Transportation costs, for example, include labor costs, which lead us immediately to the consumers' retail demand; the machinery costs lead us back to the factory, the mine, and many other places where tools, machines, supplies, fuels, and the other goods and services needed to manufacture the transportation equipment are produced. We find in every instance the laborer going to the retailer for his merchandise. The retailer must make use of the marketing organization and the complicated price system to meet the demand.

The following quotation emphasizes not only the interdependent but also the dynamic character of prices.

The broadening of the approach to the study of prices which has characterized work in this field in recent years is due in large part to the introduction of the conception that prices constitute a unified, coherent system. This conception emphasizes the fact that no one price is an isolated, independent phenomenon. From each price lines of relationship run out to all other prices coeval with it in time and back to previous prices, while similar lines run forward to affect future price quotations. Every price is connected by immediate or remote bonds to every other price.

Within the broad system of prices which is formed by this infinity of ties there are numerous elements. Each of these may, perhaps, be viewed as a minor price system, with characteristic features and modes of behavior. For an understanding of the price system as a whole it is necessary to isolate these separate elements, studying them individually and in relation to the whole system. The elements entering into the complex net which is the price system are not, of course, restricted to commodity prices. The prices of human services, of land, of capital and credit, the prices of business enterprises themselves, constitute elements of the price system, and each of these has unique features.

This system is never at rest. It is a changing organism, with its parts constantly altering their relations to each other. An account of the working of the price system must, therefore, be a dynamic one. Change is of the essence of the relations which are here studied.¹

Kinds of Prices.—Economists generally recognize two types of prices—normal price and market price. Normal price is the price at which goods and services would change ownership if free and unrestricted competition prevailed; if accurate market information were distributed promptly and uniformly among both buyers and sellers; if all buyers and sellers were equally aggressive, shrewd, and exercised good judgment with reference to present and future conditions of supply and demand; and if the forces of supply and demand were so flexible that these two controlling elements of price could be brought readily into equilibrium.

¹ MILLA, F. C., *The Behavior of Prices*, p. 213.

Normal price, in other words, is a price that *tends* to approximate the *normal costs of production* over a long-time period. Market price, on the other hand, is a price at which goods and services actually change ownership from day to day, and even hour to hour. Market price reflects what buyers and sellers think of the present and future conditions of supply and demand, the degree of competition and monopoly present, and the imperfections of our marketing organization and practices. Costs of production may have little or nothing to do with the determination of the short-run market price.

Normal Price.—The normal price may be thought of as the price which over a long-run period is just high enough to bring a supply of goods and services on the market that will adequately meet the volume of demand prevailing. During relatively short periods supply may be considerably above or below the demand, and the market price considerably below or above the so-called normal price.

The argument supporting the concept of a normal price runs about as follows: When prices are *above the cost of production* of the marginal or representative producer,¹ new producers tend to enter the field and old producers tend to increase their output.² This increased output brings about keen competition among producers so that prices are reduced until a number of high-cost producers are forced out of business or shift to some other product or industry. This process of elimination of high-cost producers proceeds until a point is reached where the production of the least efficient producer still remaining is needed to meet the demand at the price that will just cover this cost. When prices are *below the cost of production*—so the argument runs—the volume of production is likely to be reduced below the needs of those willing to pay a higher price. The result is that competition among buyers tends to raise prices, which in turn encourages larger production. Prices therefore are prevented from going far above or far below the “normal” costs of production of the “representative” firm for an appreciable length of time because high prices and large profits attract new producers and encourage expansion on the part of old, while low prices and losses bring about the failure of high-cost producers and prevent new producers from entering the field. The effectiveness of this procedure is, of course, greatly limited when “artificial” control devices are injected into the price determining mechanism.

¹ The marginal or representative group of producers are those whose costs of production limit the volume of production that can be supplied at the price the consumers are willing and able to pay. “Marginal costs equal marginal revenues.”

² This principle has been exemplified again and again; for example, the attempts to “control the prices” of copper, coffee, rubber, wheat, and cotton have invariably been followed by increased production. Arbitrarily raising the prices of gold and silver greatly stimulated production.

Prices and Production.—Both demand and supply are affected by prices. They, in turn, are causal factors in price determination. Thus if the price of a product is increased appreciably and the demand for it is elastic, the volume of sales tends to decrease sharply; or if the price is reduced, the sales tend to increase substantially. An increase in prices, on the other hand, tends to increase production while a decrease in prices, generally speaking, tends to decrease production.¹

Many interesting illustrations of the effect of price on production may be found in our experiences during the period of the World War. The east, south, and California, for instance, greatly increased their swine production during this period in response to the high prices paid; during the post-war deflation these regions reverted to or below the pre-war level of production. High prices during and following the war period brought about great expansion in the productive facilities of wheat, cotton, rubber, coffee, sugar, steel, copper, automobiles, radios, buildings, and many other products. Low prices later tended to bring about a severe contraction in production through elimination of high-cost marginal producers and curtailment of production by others. The rate of decrease in the production of agricultural and natural products was slower than the rate of increase during the boom period. This was due to political action which gave aid to the harassed agricultural producers, and to artificial control among the producers of natural products.

Costs and Prices.—When goods are freely produced under conditions of varying costs among different producers, prices are determined largely by *marginal vendibility* of the supply and the costs of the typical firms.² When the costs are constant, which is a rare situation, and the supply constantly flexible, the price is determined by the cost of production. Competition among producers tends to cause them to reduce prices to the minimum, which is the cost of production plus a small profit. Under conditions of increasing and of decreasing costs the tendency is for prices to be determined by the costs of the typical group of producers. Increased demand in an industry operating under conditions of decreasing costs may cause an increase in price for a time, followed later by a decrease in price due to the lower costs made possible by increased volume. The small-scale higher cost producers tend to drop out.

The Relation of Prices to Supply and Demand.—The price of a good tends to rise when: (1) the supply is fixed and demand increases; (2) demand is fixed and supply decreases; and (3) when demand increases more rapidly than the supply. Prices, generally speaking, tend to

¹ This statement is based on the assumption that costs remain unchanged.

² Marginal vendibility is the resultant of two forces—diminishing utility of successive units, and inequality of incomes. Taussig, F. W., *Principles of Economics*, Vol. I, p. 123.

fall when: (1) supply is fixed and the demand declines; (2) demand is fixed and the supply increases; and (3) supply increases more rapidly than demand. If demand and supply increase or decrease the same relative amount simultaneously, the price is not likely to change. The result would depend, however, upon the degrees of elasticity of demand.

The extent of the effect of a change in price on demand depends primarily on the degree of elasticity of demand for the product, while the effect on the supply depends on the character of the producing unit in relation to the amount and flexibility of the fixed capital, overhead costs, the financial resources of the management, and the likelihood of a more or less permanent increase or decrease in the price. The attempts of producers and dealers in the market "to anticipate the future trend of prices prevent prices from being the result merely of the mechanical adjustment of supply and demand schedules." Normal price, since it is the result of economic and social conditions, is not necessarily a morally, ethically, or socially desirable price.

The fact that there is a definite relationship between prices and sales, and also that difficulty is encountered in an attempt to definitely measure this relationship is indicated in the following statement by Mr. Knauth.¹

From this it follows that to increase the demand for any article means that it must not be simply lower priced as compared to the accustomed price—it must actually be so priced that the new price opens up an entirely new level of demand. This is not accomplished by any automatic process of 25% or 50% reduction or any other formula that I have been able to find. I think it is more subtle than that. It depends on a study of the normal price ranges paid by different income class levels for different types of goods, and of course there are progressively more persons in each lower income class level. I take it then that it is merely a matter of chance that a 25% reduction sale does or does not bring in a largely increased demand. The same chance runs true in a third-off reduction or a half-off reduction sale, though in those cases the margin becomes so wide that it is almost certain that a new income class demand has been opened up. Even there, however, it is not always the case.

There was no increase in sales when the price of Sarouk rugs was reduced from \$219 to \$189. In fact, \$234 was about as favorable a price as any of them.

Finding the level of demand, then, in a changing price system is an extraordinarily difficult thing and it is no wonder that most of us have blundered as badly as we have. But I think if we appreciate the elements involved and the focal point at which judgments and experience can most accurately guide us, the error can be marvelously reduced.

The sales of products that enjoy a stable demand may be affected by rather moderate changes in prices. The following statement indicates how certain price changes affected the sales of gasoline.

¹ KNAUTH, OSWALD, of R. H. Macy & Company, in a talk before the Boston Conference on Retail Distribution.

The interrelations of the various factors affecting gasoline consumption differ widely from state to state. A one cent increase in the price of gasoline in Pennsylvania causes the motorist to use twelve gallons less gas a year. In Kansas a one cent increase causes a decrease of but three gallons. An added mile of good highway increases consumption twice as much in Virginia as in Mississippi.

* Psychological factors also play an important part. In 1926 the Virginia tax rate was increased $1\frac{1}{2}$ cents. The resulting decrease in consumption was more than twice as great as that caused by a 1 cent price increase. Again in 1928, when another $\frac{1}{2}$ cent was added to the tax rate, the decrease in consumption was 14 gallons per car, instead of the five gallons which one would expect from a $\frac{1}{2}$ cent increase. The same phenomenon was noted, to a greater or lesser degree, in all the states studied.

The net effect of all these factors is expressed in a mathematical formula, called the demand law for gasoline, which enables us to tell, within two per cent, the annual consumption of gasoline per motor vehicle, if we know the price, highway mileage, and other factors involved.¹

Price Determining Factors—Market Price.—Market price is the price at which sales and purchases are actually made; it fluctuates in agreement with the changes in the market judgments of the buyers and sellers as to the prospective relation between production and consumption. Market price at any given time, however, does not necessarily cover the cost of production for the marginal firm. This happens only when producers have accurately forecast supply and demand. After a good has been produced, the character of the demand and the volume of supply rather than the cost of production tend to determine the price. When the product is a perishable good it must be sold immediately at the price the buyer is willing to pay, or the seller is likely to suffer a total loss. If it is a non-perishable or staple good the seller may be able to bargain by withholding a portion of the supply from the market. The success of this plan, however, depends upon other sources of supply, the possibility of using substitutes, and the intensity of the need of the possible buyers.

The market price depends upon a host of factors that influence the supply of the product on the one hand, and the demand for it on the other. The supply is influenced by the costs of production, which reflect prices paid for various elements that enter therein, such as labor, capital, land, insurance, and raw materials; by weather conditions; and by producers' judgments of the relative strength of demand now, and what it may be in the near future.

It is a commonly recognized fact that different producers are likely to have different costs of production. This is due to one or more possible reasons, such as utilization of more fertile land, better climatic

¹ Report by Perla, Victor, and Roos, C. P., formerly of the Division of Economic Research and Planning of the N.R.A.

conditions, more advantageous transportation and storage facilities, superior methods and machinery, patented or secret processes, or more favorable locations. Price, in these situations, tends to conform with the costs of the typical or marginal producer, and not with the costs of the least efficient members—because competition tends to force them out. Their place may be taken by others just as inefficient, but, if so, they will disappear as soon as they have exhausted their financial resources or their credit.¹

The following quotation explains the mechanics of price determination under conditions of free and unrestricted competition.

It may be said that when competition exists among both buyers and sellers, a prevailing market-place price is found which is uniform at the market place, except for such variations as account for slight differences in quality, and quantities purchased, or are explained by traders' changing estimations of the market. This prevailing uniformity of price results from the fact that in large measure various portions of the goods in the market may be substituted for each other and therefore indifferently chosen; and from the fact that most buyers will not pay a price higher than that for which they can get the good from another. The prices in two different market places, moreover, do not differ, except temporarily, by more than transportation costs and handling charges, for competing traders will ship goods and level off the price differential.

At the market place, each buyer, buying from various sellers, pays a uniform price to each; and each seller, selling to various buyers, receives a uniform price from each. The rivalry of competition, with its narrow profit margins, prevents a seller from charging high prices to a few and unreasonably low prices to others. Buyers are quick to compare price and quality, and as soon as a buyer sees that he is being charged more (considering quality) than the price charged by a rival he will change his patronage. Also rival sellers, welcoming ordinary gains, will not allow another seller to get a higher price. If a seller should attempt to curtail his supply and raise prices in one competitive market and sell at unreasonably low prices in another, he would find that competitors would quickly absorb any advantage that he might have created. A seller with competition, therefore, is effectively precluded from practising discrimination; that is, from making a difference in prices without a corresponding difference in quality, service, or conditions in the terms of sale; or from not making a difference in prices for a difference in the service rendered.

Inasmuch as the market good is exchanged at the market place, it is generally necessary to ship it to or from that place as the case may be. To sellers scattered throughout the market area the market-place price is reduced by the cost of shipping their goods to the buying center and to scattered buyers the market-place price is increased by the actual cost of transporting the goods to their respective residences. Delivery charges are costly and vary with different transactions, and the competitive seller is unable to include them in his uniform market-place price. Since the uniform price of competition is automatically

¹ This situation is pathetically illustrated in the independent-retail grocery field.

formed at one "central point" or market place, it is necessarily because of the transportation costs and handling charges, equivalent to non-uniform delivered prices throughout the market area.¹

Some Illustrations.—1. The Price of Lard.—An enumeration of the factors, on the supply side, that influence the price of lard serves to illustrate the complexity of the price determining factors operating in connection with a large number of commodities. Lard is a joint product; it is only one of several different products that are secured from the hog bought by the packer. It is relatively non-perishable, standardized, and may be traded in on the futures market. The price of lard helps determine the value of the hog; on the other hand, the price paid for the hog by the packer is an important element in the cost of lard.

The price of lard at any given time is influenced by: (1) The supply of hogs and, consequently, their prices; yet because of the fact that a portion of the hog can be turned into lard and stored, it is possible for the packer to pay a higher price if there is a possibility of a strong demand for lard three to six months ahead. There are, for instance, twice as many hogs received on the Chicago market in December and January as in September. A price variation that might be warranted by this wide range in receipts is kept down because portions of the hog can be manufactured into lard, bacon, and hams, and delivered to the consumer throughout the year. It is said that the price of hogs at any time is influenced by the probable prices of provisions for six months in the future. These probable prices are established in the futures markets for provisions. (2) The relative supply of corn and its price. A large quantity of low-priced corn encourages farmers to feed their hogs longer; high-priced corn and low-priced hogs cause the producers to market their swine earlier. (3) The amount of lard put in storage and in process of manufacture. (4) Relative prices of lard and fat cuts. (5) Relative price of lard in the export market. (6) Forecast of future demand and supply.²

Following the drought in 1934, a large number of light hogs were rushed to market. This caused an oversupply of bacon, fresh cuts, and other parts, but an undersupply of lard. The result was that the price of lard rose more than 50 per cent above the preceding year, while the price of live hogs fell more than \$2.00 a hundred pounds. The big decline in the exports of lard during 1930-1934 threw a large supply on the domestic market, which caused the price to fall. Prices of hogs and lard rose rapidly during 1935.

¹ MUND, V. A., "Prices Under Competition and Monopoly," *Quarterly Journal of Economics*, February, 1934, p. 298.

² Armour Live-stock Bureau, *Monthly Letter to Animal Husbandmen*, February, 1927.

2. Live-stock Prices.—The following summary of factors that influence the price of live stock serves to further illustrate the complex situation surrounding price determination.¹ The price level for live stock is the result of the interplay of many factors, *e.g.*, (1) number of animals available for slaughter in the United States and other countries; (2) quality of the animals offered for sale; (3) type and weight of live stock in relation to consumer demand; (4) condition of the export trade; and (5) conditions within the domestic market—general business conditions, the employment situation, weather conditions, and politics. Changes in any of these factors are reflected in the prices paid in the live-stock markets. Ability to foresee and discount these changes is the basis of success in the live-stock and packing industry.

3. The Price of Potatoes.—When the production of potatoes in thirty-five late-producing states falls much below 3.4 bushels per capita for the United States, the average seasonal price increases greatly over the average of years when the production is more than 3.4 bushels per capita.

The price movement, however, is determined by several factors in addition to the per capita production, *e.g.*, quality, business conditions, the geographical location of the large surpluses, transportation costs, dealers' margins, and sizes of crops in various sections. Prices are determined mainly at points where there is greatest sustained volume of sales. Large markets are both indicators and regulators of market price.² Prices of potatoes fell so low during 1935 that Congress added this product to the favored group to receive the benefits of the A.A.A. plan of benefit payments and crop control.³

Price and the Rate of Consumption.—When supply cannot be readily increased or decreased, price tends to govern the rate of consumption and thereby conserves the stock or increases the use.

The demand side is influenced by the purchasing power of the buyer, which is in turn influenced by such factors as wage levels and employment conditions; general business conditions; and by a large number of other factors that affect the ability and willingness of consumers to buy, and therefore influence the sale of goods.

Prices and Surpluses.—During the period 1930–1933 a drastic decline in the prices of a large number of commodities took place throughout the world. There was considerable discussion among economists and business men as to whether this decline was the result of deflation or of

¹ Armour Live-stock Bureau, *Monthly Letter to Animal Husbandmen*, June, 1928.

² U.S. Department of Agriculture, *Farmers' Bull.* 1578.

³ This law, the Bankhead Cotton Control Law, and other crop-restriction laws were repealed in February, 1936—following the adverse action of the Supreme Court with reference to the A.A.A.

overproduction. There is no doubt that the purchasing power of money was greatly increased when used to purchase these particular commodities, yet the stringent shortage of money and credit which usually precedes and accompanies a typical deflation movement did not appear until 1932 and 1933. The fall in prices can, it appears, be explained on the basis of overproduction of a considerable number of raw material goods and agricultural products which created tremendous surpluses. There were enormous surplus producing facilities as well as large supplies of the following:¹

- a. Agricultural products: wheat, cotton, dairy products, poultry products, coffee, rubber, sugar.
- b. Natural products: coal, petroleum, nitrates, copper, and silver.
- c. Manufactured products: automobiles, radios, buildings, textiles.
- d. Exportable services: technical information, managerial and manufacturing experience, banking, insurance, transportation, and other services.
- e. Skilled and unskilled labor: largely the result of the introduction of labor-saving machinery.

The drastic fall in prices of the products listed under *a* and *b* so greatly reduced the purchasing power of the producers of these goods that they could not consummate their accustomed purchases of manufactured goods. This situation produced unemployment with consequent lessened purchasing power among the urban population.²

Disposition of the Oversupply.—Three possible methods by which these surpluses could be reduced and prevented were suggested: (1) seek new markets abroad; (2) diversify production; or (3) curtail production. If a market is saturated, or purchasing power is reduced, then the only remedy is curtailing production, and/or artificially increasing purchasing power. The A.A.A. and the N.R.A. were designed and operated on the assumption that over-production did, in fact, exist. The natural objections of the individual producers to limitation was reduced through the benefit payments. The droughts of 1933 and 1934 furnished material aid by bringing about drastic reductions in the surplus of agricultural products. Curtailment of production, however, is seldom popular among producers and consumers. Consumers want the benefits of competition, which gives them lower prices. Each producer desires his competitors to reduce production, but he wants to increase his own output. This curtailment plan is, however, the only sure road to a solution. A restriction of world supply always tends to stimulate prices.

¹ YOUNG, O. D. *Commerce and Finance*, p. 1254, June 25, 1930.

² COPELAND, M. T., *International Raw Commodity Prices and the Devaluation of the Dollar, 1934; Raw Material Prices and Business Conditions, 1933.*

The relief sought in foreign markets is uncertain. A limited amount of relief, to be sure, may be found, but under normal conditions this solution for the general situation is unsound. Much of the surplus was due to the great impetus given production during the war and to the tremendous volume of credit advanced certain foreign countries by the United States during 1922-1929. As much of this purchasing power was used to buy American goods, production was unduly stimulated. This expansion in production facilities and large-volume buying obviously could not continue indefinitely. Other factors contributing to the formation of surpluses through stimulating production were installment selling and methods of artificial price control. Installment selling in the United States probably stimulated purchases for a period of years. When installment payments for large groups of people reached the limits set by money income, new sales ceased to increase; in fact, they actually began to decline.

The breakdown of various forms of artificial price control demoralized the markets for a number of basic products. The plans to raise and keep high the prices of rubber, sugar, coffee, copper, and nitrates so stimulated production for a period of time that the surpluses wrecked the price-control plans. Another factor contributing to the surpluses in the United States was the development of producing facilities in other countries, which reduced their importation of certain goods produced in the United States. American capital and managerial ability moved to foreign countries and established factories to produce goods which had formerly been exported from this country. The time when domestic surpluses could be dumped promiscuously into foreign markets has passed. Foreign countries now promptly take appropriate action to prevent such practice.

Monopoly Price.—A considerable degree of control over prices can be exercised by a monopoly because it can limit its output or its purchases. A monopoly is said to exist when a person or firm can exercise sufficient control over either the supply of, or the demand for, goods to enable him, under the conditions of the market, to determine the price to his own advantage.¹ The control over supply may result from (1) franchises, such as are granted to public utilities; (2) patents and copyrights granted by the federal government to individuals and corporations; (3) through ownership of the sources of raw materials, most favorable location, superior processes and methods; (4) *Cartels* and pools which may, by mutual agreement, limit production and divide territories and earnings; and (5) *codes of fair trade practice*, sponsored and supervised by state and federal governments. Limited or partial monopolies are sometimes secured through identifying a product by means of trade-

¹ GARVER and HANSEN, *Principles of Economics*, p. 253.

marks and brands, and then developing buyer preference by means of effective sales-promotion activities.

The ideal price sought by a selling monopoly is the one that will produce the greatest possible total net profit. This is calculated by multiplying the net profit per unit by the total number of units sold. To secure this ideal total net profit the unit price must not be so high that the volume of sales will be materially curtailed, nor should the unit price be so low that even though the volume of sales be large the profit on each unit is so small that the total net profit is unsatisfactory. The sales price would normally exceed the cost of a marginal producer, if there were one. A monopoly usually has to experiment for some time before it finds the ideal price. It may be advisable to adjust this ideal price as general business conditions change in order to maintain the desired total net profit. The success of a pricing plan for a monopoly depends to a considerable extent on the degree of inelasticity of demand for the product or service. If the price can be materially raised without appreciably reducing sales, an ideal situation exists.

A buying monopoly is unusual. Governments, however, can establish themselves as monopoly buyers through legislative action or dictatorial edict. Thus the government may designate itself as the only legal buyer of gold or so regulate the price of silver as to assume the role of a monopolistic buyer. An oil refiner may occupy a monopolistic buying position with reference to crude oil within a limited producing area. A manufacturing concern that depends upon one buyer—for example, a chain or a mail-order house—frequently finds itself in the position of dealing with a monopolistic buyer.

The following quotation explains the determination of price under monopolistic conditions.

It may be said, first, that monopolists discriminate between customers on the basis of their individual valuations. Thus, some individual companies (with local monopoly) quote only delivered prices; and so fix them that they will be low to customers who are near a rival, and high to those who are furthest from competition. Secondly, it was observed that monopolists discriminate between different markets by employing a system of uniform national (or zone) prices; by the basing point plan of delivered prices; or by foreign "dumping." Under a uniform delivered price system, which is represented by the extreme case of absorbing freight, sellers receive from buyers near the market place a net price greater than is received from distant buyers. The basing point system also results in a situation where all sellers, except those having mills at the basing point (and who sell only at the basing point price plus freight), receive net prices which differ by the extent to which they "absorb" freight in shipping goods toward the basing point. And the familiar case of foreign "dumping" is based upon the sale of goods in a foreign country at a price less than the domestic price plus transportation charges. Only in one case (the Pacific cannery) was it

observed that a group of monopolists, localized in a certain production center, charge a uniform f.o.b. price.

How can one account for the existence of the foregoing price differences, not based upon a corresponding difference in quality, service, or conditions in the terms of sale? Under competition it has appeared that a seller is unable to get a difference in price without making a corresponding difference in the nature of the transaction. Under conditions of monopoly, however, the price making process changes significantly. The monopolist (or group in collusion) is not forced to adjust himself to the "going" price of others; instead he can fix a price, keeping in mind such actual or potential competition as there is, and adjust his operations to secure the maximum profit. In the examples of monopoly here considered, it was typical for monopolists to discriminate among customers by making a difference in prices without a corresponding difference in quality, service, or conditions in the terms of sale, or by not making a difference in prices for a difference in the service rendered; and consequently, to receive at the market place from their customers widely varying prices. A monopolist can so discriminate because buyers, or sellers, are unable in varying degrees to turn to an independent and efficient producer. With conditions of competition, however, it was found that sellers receive at the market-place a uniform price from all customers; and that such a uniform competitive price is necessarily, because of transportation charges, equivalent to non-uniform delivered prices throughout the market area.¹

Limitations on Monopolistic Power.—There are very definite economic restraints on the full use of monopoly power. The public service commissions of the various states regulate the prices which public utilities can charge for electricity, gas, and street car service. Telephone and railway companies also are subjected to a certain amount of governmental regulation. These legal regulations and restrictions are largely the result of the arrogant attitude assumed by some of these monopolies in the early days of their development. Their experiences with governmental control have served as an object lesson for other monopolies. Such organizations now usually give consideration to public opinion and to the possible attitude of certain politicians before setting an abnormally high price. If the general public feels that the price of goods or service is unreasonably high, it may institute a boycott or start agitation for governmental investigation, regulation, and state ownership. These ever-present possibilities provide a wholesome restraint on the actions of over-ambitious managements that might otherwise be unmindful of the economic interests of the public. The efficacy of political action in bringing about a reduction in utility rates and valuations was exemplified during 1934 and 1935.

¹ Munn, V. A., "Prices Under Competition and Monopoly," *Quarterly Journal of Economics*, February, 1934, p. 298.

The competitive situation presents another restriction on the price that a monopoly may charge. There are few products and services for which some form of substitute cannot be found. The substitute may be inferior, and may be undesirable in some respects, yet many consumers may purchase it rather than the high-priced product of the monopoly. After the public has turned to the substitute it may not readily return to the original product even though its price be materially reduced. In this day of synthetic products the advantageous position of many monopolies has become quite precarious.

Unduly high prices are likely to draw competitors into the hitherto monopolized field. The attempt of the copper, rubber, sugar, and coffee producers to control prices through control of production in the major producing centers failed because the high prices resulting promoted development of production facilities in other parts of the world where the output had been negligible before the period of high prices. Germany, for example, produced 100,000 tons of synthetic gasoline in 1933; the estimated production for 1934 was 150,000 tons, and for 1935 approximately 200,000 tons. Alcohol is produced from potatoes, and mixed with gasoline; gasoline is produced also from lignite, shale, and coal. Artificial fibers are being experimented with to take the place of cotton.

Price Policies and Practices.—Acceptable marketing practice requires that the selling price be high enough to cover the expenses of production and marketing, plus a reasonable profit to the manufacturer. The retail price must cover, in addition, the necessary margin of cost and profit for the wholesaler, retailer, and other necessary functionaries. Society cannot, however, be expected to pay a price high enough to keep in operation producers and merchants whose methods are so inefficient or whose products are so inferior that there is excessive economic waste. The tendency to do this was one of the major objections to the codes.

Our previous discussion has shown that there are two limits to price. An increase in price is retarded by a tendency toward increased production and decreased sales, while a reduction in price is retarded by decreased profit which is normally followed by reduced production. Decreased supply, the result of reduced production, in other words, tends to prevent prices from remaining for a considerable length of time below the costs of production of the representative firm; and decreased sales, which may be the result of exorbitant prices, tend to prevent prices from remaining for a considerable length of time above the costs of production.¹ High prices do not necessarily bring high profits unless an entire industry agrees to maintain high prices. Competition usually forces prices down. Even if an entire industry agrees to

¹ The student should keep in mind that we refer to the "costs" of the "representative" producer.

maintain high prices, consumers usually can and will find some substitute at a lower price. Large profits are more likely to result from low prices, which are made possible through efficient production and low-cost marketing practice. The high-cost producer and marketeer, who must charge high prices will soon succumb, unless protected by some artificial arrangement, to the more far-sighted firm. It is to the economic advantage of both the producer and the consumer to have reasonable prices. The producer must constantly compete aggressively for the consumer's favor. The manufacturers of such products as radios, mechanical refrigerators, oil burners, automobiles, and washing machines recognized this principle of pricing in 1934 and 1935, and consequently enjoyed a large expansion in sales due to the lower prices quoted. Public utilities have learned that reduced rates encourage larger per customer use. The automobile manufacturers have consistently followed the practices of "giving more for less."

Prices on the Organized Produce Exchanges.—Between the two limits stated above, there is considerable opportunity for managements to manipulate prices or at least to exercise a considerable amount of control. The forces of supply and demand have an opportunity to approach the ideal state of free competition through an organized exchange. Here we find prices changing constantly during the process of establishing an equilibrium between the forces. Buyers are constantly bidding to buy, and sellers offering to sell, at stated prices on the basis of their information with reference to present supply, demand, and prices, and their forecasts of future conditions. Producers and buyers as individuals can exercise very little control over prices in such markets. If they buy or sell in these markets, they must accept the prevailing prices. The individual farmer, miller, packer, and other producers and buyers of goods used as raw materials must take or pay the market price prevailing at the time they may negotiate their transactions, irrespective of the cost of production or the profit to the producer. Prices of goods traded on organized exchanges are the most sensitive of all prices to the fluctuations in the action and interaction of the forces of supply and demand.

Wholesale and Retail Prices.—The wholesale markets for manufactured goods are not so highly organized as the produce exchanges. The movement of prices, consequently, is somewhat more sluggish. Market news is not so uniformly distributed. The elements of cost for many wholesale products are fairly stable so that if the cost of the raw material does change, it may not greatly affect the cost of the finished product. The cost of raw wool, for instance, in a \$50 suit of clothes is only a small fraction of the wholesale price.

The retail markets reflect changes in supply and demand much less promptly than the wholesale markets. Consumers become accus-

tomed to paying certain customary prices and strongly resent an increase in such prices while they are not insistent on frequent reductions. When a retailer receives a shipment from the wholesaler or manufacturer, he usually tries to sell it at a uniform mark-up. He is not likely to raise or reduce his prices until he receives a new shipment even though wholesale prices have changed. The customary attitude of the consumer encourages this practice. The more recent practice of hand-to-mouth buying on the part of retailers, the emphasis on rapid turnover, and the aggressive selling policies of chain stores have tended to make retail prices more sensitive. There may be a wide variation in the prices of identical goods sold in retail stores on the same street within two or three blocks of each other. Some producers and merchants attempted to eliminate this practice by means of codes. Only partial success, however, was attained. Changes in prices move slowly from the raw material markets through the wholesale markets to the retail markets, and with greatly diminished intensity.

There are occasions when the impetus comes from the consumer. Retail prices may be forced down by greatly decreased sales, so-called buyers' strikes; or the consumers may begin to buy in larger quantities, or more frequently, so that the retailer's supplies are soon exhausted. The retail merchant orders from the wholesaler whose stocks likewise are quickly depleted, and who then sends larger orders to the manufacturers. The manufacturer, as a result of this increased activity, steps-up production, buys more raw materials, hires more workers, and purchases more machinery, supplies, and equipment. The raw material and wholesale market prices quickly reflect the changed situation.

Goods sold to industries are sold largely on a specification and price basis. The knowledge and skill of the purchasers for these industries are such that they can bargain on a basis of equality with the sellers. Competition is keen among sellers for the business because of the large potential supply resulting from the ability to quickly expand production facilities. The result is that prices tend to approach the cost of production of the representative firm, and in some instances, the cost of the highly efficient firms. Since the demand for this class of goods is, generally speaking, inelastic, sales cannot be stimulated by moderate reductions in prices. A reduction in the price of steel, for example, would not encourage a manufacturer of typewriters to increase his purchases of this commodity.

Merchandise that can be given an individuality or distinction of its own, or is produced by a firm whose prestige is great, may be sold on a quality rather than on a cost basis. Competition among sellers in such cases is not so great; consequently, the price may cover a semimonopoly profit. Such merchandise and services are said to be sold at the market

plus. Professor M. D. Taylor reached the conclusion, based on his price study in Durham, N.C., that branded merchandise which competes directly with the same commodities sold in bulk or for which cheaper substitutes are readily available, declined the most during the depression; brands which do not compete directly with bulk products, or for which no exact substitutes are readily available, or which, because of extensive advertising, occupy a somewhat exclusive position, declined least.¹

The Consumer and Retail Prices.—Some consumers rely on price as a guide to quality. This permits and encourages the unethical seller to charge prices higher than costs warrant. Two brands of shoes, hats, or suits, for instance, may be of essentially the same quality, style, and other features of desirability. One brand may be priced at 25 to 50 per cent more than the other, yet it might be sold just as readily as the lower-priced article—and, in some cases, even more readily. This is possible because some consumers think the higher priced article is the better value; or they get a certain amount of pleasure in paying a higher price than some of their neighbors.

Retailers, wholesalers, and manufacturers have learned from experience that there are definite prices which people are willing to pay for certain articles. What these prices are depends on the class of clientele catered to, the nature of the product or service offered for sale, and general business conditions. This situation encourages production of articles to sell at these prices. Quality may be reduced in order to make it profitable to produce and sell the article at the given price. The merchandise sold in the chain variety stores, some department and mail-order stores, and chain shoe and clothing stores furnish good illustrations of "articles built to a definite price."

These limitations placed on prices by the consumer have led some retailers to adopt the practice of *price lining*; i.e., the management concentrates its marketing activities on merchandise meeting specific demand levels. Some retailers establish three price ranges for each major line of merchandise. Thus all shoes stocked by a given retailer may be priced at \$2.50, \$3.50, and \$4.50 a pair; men's suits at \$22.50, \$27.50, and \$32.50 each. The merchant, on the basis of his experience and observation, sets such prices at the levels which, he believes, will meet the approval and purchasing power of the greatest number of possible buyers. When there is a major shift in general prices so that the purchasing power of money and the costs of production are greatly reduced or increased, these specific prices may have to be raised or lowered accordingly. Some producers and merchants try to maintain their established price levels and absorb small losses and retain small extra

¹ TAYLOR, M. D., "Prices of Branded Grocery Commodities During the Depression," *Harvard Business Review*, pp. 437 ff., July, 1934.

gains due to minor shifts in the general price levels. Others have maintained their levels by reducing quality and quantity¹ when general prices rise and by giving better quality when general prices fall. Competition, however, among producers and merchants tends eventually to force new prices on the upper or lower level as the case may be.

Merchandise made to order and that produced by semimonopolies is usually priced on a cost-plus basis; that is, the cost of production and marketing is rather accurately calculated, the desired margin of profit added, and the price set accordingly.

Price Quotations.—The result of the action and interaction of the complicated forces that determine prices finds expression in price quotations. Prices that flow from organized exchanges result from the competitive bids and offers of buyers and sellers. Prices of many materials and services traded in among individuals in the unorganized markets are the results of "higgling" and "bargaining." The prices of a large number of manufactured goods that pass directly from the producer to the user and through the various forms of middlemen are quoted according to trade custom and firm policy. Some of the more commonly used forms of price quotation are discussed in the following pages. The student should bear in mind, however, that the firm does not arbitrarily set the price. Its prices must, in the long run, reflect the competitive situation, the costs of production and marketing, the condition of supply and demand of goods, and the effective supply of money or credit.

The One-price Policy.—A large number of manufacturers, wholesalers, and especially retailers, have adopted the one-price-to-all policy. This means that during a given time interval goods of the same quality and amount are sold to all buyers of the same classification at the same price. Higgling is, under no condition, resorted to. This policy, however, does not prevent price changes. A commodity may be sold during one month, week, or day at \$5, for instance, and the next day, week, or month be sold at \$4 or any other price the management may find advisable. The characteristic feature is that all buyers are required to pay the same price during the given period. If the prospective purchaser needs or wants the article intensely enough to pay the price asked, he buys; if not, he refuses to buy at the asked price. No time is wasted in arguing about the terms. If the seller finds his sales seriously reduced because of the price, he may eventually lower it.

Contract Price.—Some prices are quoted on a contract basis; i.e., a firm agrees to supply a certain quantity of goods or services of a given

¹ Some producers have attempted to solve the problem by using the questionable practice of keeping the same size package, for instance, but reducing the amount or quality of the contents. The consumer resents this attempted deception.

quality for a given period of time at a stipulated price. This price may be the result of competitive bidding, individual bargaining, or it may be quoted on a cost-plus basis. Coal, copper, timber, construction work, and individual services are sold, usually, on a contract basis. A number of labor unions enter into such contracts with employers. Milk producers' associations and distributors frequently deal with each other under the contract form.¹ This form of price quotation performs an economic function by removing the risk of change during the period covered by the contract.

Charging What the Traffic Will Bear.—Producers of monopoly and semimonopoly goods sometimes set their prices on the basis of "what the traffic will bear." Because of the favored position held by the producers of such merchandise and services, the producers can quote a price that will give them the greatest total net profit. Competition among the sellers is not usually keen enough to force prices down to the cost of production of the least efficient producer. The character of the clientele is usually such that a considerable number of buyers are able and willing to pay a price that furnishes a fairly wide margin of profit on each unit. Products whose demand is inelastic furnish the best opportunity for charging what the traffic will bear.

Basing-point Systems.—A price may be quoted as if a product were manufactured and shipped from one point, when in fact it is produced and shipped from another point. At one time steel sold in the Middle West was quoted on the Pittsburgh-plus basis. Thus a manufacturer in Milwaukee would be quoted the Pittsburgh price plus freight from Pittsburgh to Milwaukee, when in fact the steel might be produced in, and shipped from, Gary, Ind. This system was possible as long as the Mid-west area had to depend on the Pittsburgh and Youngstown production centers for a portion of its supply. After the Chicago-Gary steel center was developed to the point where it could supply the demand of this section, the Pittsburgh-plus plan was abandoned. The rapid development of production units in market centers throughout the country tends to diminish the desirability of using the basing-point system.

Some of the arguments against the basing-point system are indicated in the following quotation taken from a report by the Federal Trade Commission to the President:

The Commission concludes that not only has the basing point system distorted normal competitive relationships among producers, but also among fabricated consumers. It has given an advantage to such consumers located at basing points over those not so located. It has placed it within the power of

¹ Under a Wisconsin law the state can set the minimum price that can be paid the farmer for his milk.

those determining the location of such basing points thereby to determine what cities shall be built up by making them basing points and what cities shall be handicapped by refusing to make them basing points. Thus natural advantages of location are ignored and an artificial basis is given to industry, which in turn is reflected in the prices of both fabricator and ultimate consumer by including artificial transportation charges.

The basing point system provides "unfair competitive advantages for producers" over consumers in that it makes identical delivered prices for all producers at any given delivery point and so deprives the consumer of the benefits of price competition. These advantages are "not based on natural causes" since they are gained by neutralization of natural advantages and disadvantages.

The disadvantages for consumers, therefore, resulting from the basing point system are in no case "based on natural causes," since the basing point system itself is characteristically artificial and its chief effect on the consumer is through prices either artificially high or artificially discriminatory. As to the latter the basing point system may be so administered by the code authority, the Board of Directors of the Steel Institute, that prices to buyers in one territory may be made less than the regular delivered price, while no concession is allowed to buyers in adjacent territory. Instances of this are cited in the report. By such action of the code authority, Toledo fabricators are compelled to pay several dollars a ton more for their steel from Pittsburgh or Cleveland than fabricators at Detroit, Lansing, Pontiac and other Michigan points for the same steel hauled through Toledo.¹

Some of the consequences of the utilization of the basing-point plan and some suggested remedies are indicated in the following statement.

One consequence of basing delivered prices upon a point which is not the actual shipping point of the seller is that every such non-basing-point seller discriminates between his customers in the prices which he charges them for his product. A second significant characteristic of the basing-point system is the sharing of territories which it promotes as between shippers located at different points. The price relationships of the basing-point system make it possible and probable that a sharing of territories becomes general over a wide area. Basing-point sellers are able to sell without sacrifice to any point in that territory. The non-basing point seller on the other hand, receives low net returns on sales toward the basing-point and beyond, but makes up the deficit through the high returns received in the area near its plant where it has an advantage in freight rates over the basing-point.

A third consequence of basing-point prices is the levying of larger total freight costs upon consumers because of the cross-hauling. Under a system of mill-base prices the amount of such excess freight incurred would probably be insignificant as compared with the very extreme amount of cross-hauling which appears to be normal in the basing-point industries that have been studied.

As to remedies, one substitute suggested is the mill-base system in which each mill at any given time charges uniformly to all customers its one current price at the mill regardless of destination. Some compelling force would be required

¹ Quoted from *Domestic Commerce*, p. 163, Apr. 10, 1935.

to install and retain this system, as it is no more natural or self-sustaining than the other.

Increase in the number of basing-points employed in a multiple basing-point system appears as a step in the direction of striking a balance between the two extremes, but this would reduce neither cross-hauling nor discrimination in prices.

A more promising substitute would be to place a limit on price discrimination, to stimulate price competition. Under such a rule each mill would sell at its maximum mill price in the territory surrounding its location, and would expand that territory outward until it reached a point where the delivered prices of another mill would prevent it from getting its maximum return. Beyond that point it would continue into the territory of other mills, receiving less than its maximum net return in doing so. Instead of reciprocity in the matter of sales areas there would be mutual exclusion, reduction in the limit of permissible discrimination would confine each mill more strictly to the area carved out for it by the relation of its base price to the base price of other mills. The incentive to price competition would be called into play, but could be controlled by the extent of discrimination permitted, and it need not be pushed so far as to lead producers to eliminate themselves from the competitive picture through consolidations or secret price agreements.¹

As competition becomes keener among producers of standardized products, raw materials, and supplies, there is a tendency for prices to be quoted by the nearest producing center plus freight from this point. Competitors who are not so favorably located may be forced to quote the same delivery price. The less favorably located producer in such instances may actually pay part of the freight in order to get part of the business. Manufacturers of merchandise of small bulk and weight and of high value usually quote a flat rate applicable throughout the country. Manufacturers whose products are bulky frequently absorb part of the transportation costs by quoting prices on a zone basis; i.e., the country is divided into districts or zones, and the price quoted in each district is uniform.

An identified and nationally advertised product may be held in such high esteem that the producer can quote f.o.b. shipping point prices, in which case the purchaser pays the freight from the factory.² This practice is rather generally followed by the automobile industry.

¹ MONTGOMERY, DONALD E., Consumers Counsel Division of the A.A.A., "Basing-Point Prices," in *National Marketing Review*, Summer, 1935; digested in *Domestic Commerce*, June 20, 1935.

² Some other forms of quoting prices are: c.a.f. (cost and freight) sales—the selling price includes freight charges to destination and all taxes are paid by the shipper; c.a.c. (cost and charges) sales, same as f.o.b. except selling price includes freight, icing and heating charges to destination, and any taxes involved; c.i.f. (cost, insurance, and freight) sales, an f.o.b. quotation which includes taxes, insurance, and freight charges to destination; s.a.p. (subject to approval of price) sale—this is really a future sale with the price to be named later based on the cost of production—it is used in the

Customary Prices.—Habit is an important factor in the retail field. Consumers become accustomed to paying a certain amount for articles bought frequently and used continuously. The merchant, realizing the ill will that is likely to develop if he raises prices, usually does not lower them unless he is forced to do so by competition. A large number of retailers set their prices by using a commonly accepted mark-up system. The percentage figure may be different for different products. Certain rapidly selling staples, such as sugar, have a relatively low mark-up figure, while highly perishable products, such as fruits and vegetables, may be burdened with a high mark-up because of the risk of loss from spoilage. Slow-moving merchandise, such as jewelry, will customarily carry a high mark-up. The controlling factor back of the size of the mark-up figure is the *cost of selling*.

Follow the Leader Plan.—There is in many industries one outstanding producer whose position and prestige are such that the other manufacturers look to him as a pace setter as far as pricing is concerned. The small producers may feel that it would not be to their interest to reduce prices below those quoted by the leader because he might start a price-cutting contest. If the industry were one of decreasing costs, the larger producer would have such an advantage that he could probably drive the smaller producers into bankruptcy. Even if his advantages in production were not important, his superior administrative organization, financial resources, and efficient marketing methods would probably give him an advantage.

When there are a number of producers, all more or less on an equally strong competitive basis, one may be accepted informally as the leader, or informal meetings may be held in which information that can be used as a guide to the group is given out, so that prices quoted by each producer will be essentially the same.

The Open-price Association.—The purpose of this type of quotation is to stabilize prices and prevent underselling among competitors. It provides a means by which the prices that are being quoted by each member of the association become available to all other members. This plan was in vogue in several industries during the time of the codes.

On Basis of Classification of Buyers.—Some producers quote prices on the basis of some classification of the buyers. Thus the wholesaler is quoted one price, and the retailer a higher price. If sales are also made direct to the consumer, he will be charged a price higher than the one quoted to the retailer. This system requires a definite classification of

canning industry; "to arrive" quotation—a price is offered if the merchandise arrives within a certain definite period of time at a designated destination—the seller assumes the risks of loss and damage in transit, and pays freight and other charges; the buyer assumes the risk incident to price fluctuation.

buyers, which is not always satisfactory to all the parties concerned. Chain stores want a wholesale classification; many small wholesalers object, and insist that the chains are retailers—even though they may buy in tremendously large quantities—and that they should be forced to pay the prices quoted to other retailers. There was much controversy during the time of the N.R.A. as to the classification of buyers, the rate of discount which each one should receive, and the retail price to be paid by the consumer. The objective was to stabilize prices and reduce price competition.

The Use of Discounts and Allowances.—The difficulties arising in working out a satisfactory classification of buyers have led a number of manufacturers to quote prices at a certain discount from the list price. The list price is quite frequently the suggested retail price. The discounts vary according to the volume of purchases made by the wholesaler or the retailer as the case may be.⁶ Thus one company quoted quantity discounts as follows: on a purchase of five cases 1.1 per cent was allowed; on twenty-five cases, 2.2 per cent; and on a carload lot the discount granted was 4.4 per cent. The quantity discount is justified on the basis that marketing costs per unit are lower when goods are sold in large quantities to individual buyers.¹

Some manufacturers allow a specified discount if the merchant stocks the full line of the producer's goods; others allow a discount from the list price if the merchant gives the merchandise preferred display position in his store.

A committee of Congress found in its chain-store investigation that the Great Atlantic and Pacific Tea Company received, during 1934,

¹ The primary purpose and effect of the quantity discount is to encourage larger orders. Outstanding among the advantages which accrue from larger orders and which benefit the general public as well as the manufacturer, are: (1) They reduce production costs; (2) reduce selling costs; (3) increase consumption; (4) increase the manufacturer's profit; (5) reduce the consumer's price; (6) by increasing consumption of the product they not only increase employment but likewise increase the consumption of the raw material entering into its manufacture, and employment among those engaged in producing such raw materials; (7) tend to raise the general standard of living.

Obviously, if one can make it worth while for a prospective customer to buy a carload instead of twenty cases, you are protected against the loss of that customer's business, with respect to the difference between the twenty cases and the carload purchase. Selling a larger order insures, to a certain extent, against a competitor's getting part of your customer's business. It makes no difference whether the quantity discount is granted in return for the immediate purchase and delivery of a given quantity of goods or takes the form of an "annual" or "periodic" discount for the purchase of a given quantity of merchandise within a specified period. Godfrey M. Lebar, Editor of *Chain Store Age*, "Quantity Discounts—A Defense," in *The American Marketing Journal*, July, 1935. Digest published in *Domestic Commerce*, Aug. 10, 1935.

in the form of advertising allowances \$6,105,000 plus brokerage earnings of about \$2,000,000.¹ The allowances were granted on the basis of contracts between the chain-store organization and 343 manufacturers. Some manufacturers allowed 2 per cent, while others allowed as much as 20 per cent. General Foods, for example, allowed approximately \$30,000 a month, or \$360,000 a year, on an annual purchase by A. & P. of approximately \$9,000,000 worth of merchandise. This is equal to a discount of 4 per cent. The monthly figures were adjusted, however, so that the allowance equaled 5 per cent of purchases. The total sales of A. & P. for the year ending February 28, 1935 were \$842,015,871; the cost of the goods was estimated at 80 per cent of this amount, or approximately \$674,000,000. The advertising allowance therefore is slightly less than one per cent of the wholesale value of total purchases.²

It is obvious that the chain cannot mention the hundreds of individual products purchased from the 343 manufacturers in its newspaper and radio advertising each week. These manufacturers do, however, receive valuable sales-promotion service from window and store displays—there are 15,200 A. & P. stores—counter cards, counter and shelf arrangements, and the prestige of the chain. A large proportion of the so-called advertising allowance should, no doubt, be called a discount based on quantity purchases by the chain. There is a question as to whether this practice is unfair. The small independent grocer believes that it is; the consumer who receives a benefit in the form of lower prices may not be so sure.

To overcome seasonal buying and to even out the production schedule, the producers of certain seasonal goods have found it advisable to give discounts on merchandise bought by merchants during the off season. Forward dating of invoices, which is a form of credit granting, is sometimes used for the same purpose. Free deals, an extra case of goods, or some other stated quantity of the merchandise bought are sometimes given the dealer to create goodwill, introduce a new line, and to secure more intensive cooperation. These free deals, unless they are in payment for some additional service furnished by the merchant, constitute reductions in price.³

¹ *Sales Management*, July 15, 1935. The discounts received by a number of other chains were revealed by the committee in its later investigations.

² The reader should bear in mind that the investigation did not show that the A. & P. company was the only purchaser receiving discounts and allowances from the manufacturers.

³ The free deal, according to L. S. Lyon, is a method of pricing and merchandising in the field of branded, standard-price products. Six factors are involved in its use, viz.: a giver, a recipient, a basis for the offer (either purchases or sales by the recipient), a gift, dimensions of time, quantity, area, and value, and the presence or absence of familiarity with the revenue product or service.

Dr. Lyon contends that the free deal is an effective device. He believes that it

The amount of the discounts and the conditions under which they are granted depend largely on the custom of the trade and the degree of competition prevailing. There is a possibility that a discount plan may degenerate into a rebate practice. The courts have held that secret rebates may constitute unfair practice.

Odd Prices.—At one time retailers typically quoted prices in "round" or even figures, thus 5, 10, 25, 50, 75 cents, and the dollars. Chain stores and mail-order houses, among others, quote many prices in odd figures; for example, 17, 19, 23, and 98 cents. These prices are probably used because they give the impression that they have been reduced from a higher price. The prices 19, 21, and 23 cents may lead the buyer to think the original price was 25 cents. Some experienced merchants believe that a price of 79 or 83 cents is just as good as 75 cents, if not better. These odd prices cause inconvenience in making change, and in a great many cases not only do not represent reductions, but may actually be advances over the customary price. When they are the result of real reductions, they are acceptable, but when they are used simply to deceive the unsuspecting buyer, the management is following low business standards.¹ The following statement presents an interesting discussion of the practice of using odd prices.

For many years retail merchants have quite generally believed that the use of odd prices increases the sale of merchandise. I have not done sufficient research on this subject to determine when the use of odd prices became prevalent throughout the retail trade. I do know, from my own retail experience, that

works better than price reductions, and so long as this is true it must be used by all competitors if it is used by any. Deal givers believe that deals are seductive even in selling to mercantile buyers; therefore strong arguments against them must be brought forward before deal givers relinquish their use as a form of sales strategy.

This report shows how the more or less harmless policy of allowing the dealer a small amount for advertising or promotional work which he might do at the point of purchase has gradually evolved into a sharp competitive tool which has become in one form or another a matter of concern both to courts and to trade practice conferences.

One maker of women's toilet goods is reported as having spent, in 1928, \$2,218,000 for "space" in the usually accepted media and \$2,150,000 for "allowances." In 1930 the picture had so changed that only about \$760,000 was spent on space advertising while \$3,500,000 was spent on "allowances."

A maker of smokers' accessories is reported as giving \$422,000 for "cooperation."

The Gillette company is reported as agreeing to pay to the Schulte company in 1930 about \$500,000 for featuring Gillette blades that year.

When such sums are being handed out it is only natural that manufacturers, wholesalers, chain stores, brokers, and retailers become involved in very serious conflicts of interest. Leverett S. Lyon, *Advertising Allowances—A Phase of the Price-making Process*. Washington, D.C.: The Brookings Institution, 1932.

¹ Some department-store managers say they use odd prices as a means of controlling the sales force. Since odd prices usually necessitate the making of change, they tend, it is argued, to discourage dishonesty on the part of the salesperson.

for the past 15 years, odd prices have generally prevailed rather than even prices in the marking of merchandise to be offered to the public.

Does this practice really sell more goods? I am frank to say that I do not know, and I doubt if anyone else knows the exact answer to this question.

An article is presumed to sell better at 95¢ or 98¢ than at \$1.00, because, psychologically, the customer thinks of it in terms of less than a dollar. Similarly, an article at \$1.95 is presumed to sound considerably less expensive than when marked \$2.00. Recent experiments which we have made at McCreery's, have led me to question the blind faith that most merchants, particularly advertising managers, merchandise managers, and buyers, have in the appeal of odd prices.

There are certain prices for particular items, such as handbags for \$2.95, that have been featured by all stores for such a long period of time that they have become the accepted prices. As the customers finally determine many things for us, I realize that in such cases, we retailers have set upon a path from which there probably is no turning back. However, just because we can sell more handbags at \$2.95 than we can at \$3.00, it does not follow that more dresses can be sold at \$24.75 than at \$25.00, nor more chairs at \$14.95 than at \$15.00. In my opinion, too many of us merchants have a tendency to generalize from specific instances. Because we can prove that a certain odd price is what customers are used to and, therefore, what they expect in a specific instance, we apply this as a principle to our entire scheme of price lining.

When New York State passed a Sales Tax law a year ago, forcing retailers to pay a 1 per cent license tax to do business, merchants discussed ways and means of passing this tax on to the consumer. In New York City an experiment was tried whereby 95¢ items were raised to \$1.00; \$1.95 to \$2.00; \$2.95 to \$3.00; \$3.95 to \$4.00; \$4.95 to \$5.00, etc. This experiment was not particularly successful, partly due to the fact that one or two leading merchants failed to follow the plan, and this competition had to be met. Also, there was the fact that certain items of merchandise, as mentioned above, particularly those items that had been featured for years at a certain price, had become fixed in the minds of consumers, and there was customer resistance. The entire experiment was not a failure, however, and from it some of us gained interesting lessons. We discovered that we could sell men's ties as readily at \$1.00 as we could at 95¢; we discovered that 75¢ sold as much hosiery as was formerly sold at 69¢; that \$1.00 was equally as good a price for women's hosiery as was 95¢; that in silk underwear \$2.00 and \$5.00 were excellent price lines, instead of \$1.95 and \$4.95, although there was some resistance at \$3.00 as compared to the old \$2.95 price; we found that dresses at \$16.50 sold equally as well as at \$15.95; and that in the upper brackets of ready-to-wear, furniture and home furnishings, customers apparently were unaware of the fact that merchandise was now being offered at even prices.

Our handbag buyer is now forced by competition to use a \$1.95 price for most of her bags selling at around this figure. She recently was able to secure a splendid assortment of washable summer bags that were not offered to anyone else in the city. Even though we use the \$1.95 handbag price, we marked these particular bags \$2.00, and in the first few days sold 2,800 of them, with \$1.95 handbags just a few feet away.

In our silk department we formerly used 95¢, \$1.35, \$1.65, \$1.95, \$2.95, \$3.95, etc., as regular price lines. We have changed these prices to \$1.00, \$1.50, \$1.75, \$2.00, \$3.00, \$4.00, etc., and have not felt that this has been inimical to our sales volume.

We have not done sufficient experimenting nor have we records over a long enough period of time, to justify us in coming to a definite conclusion in this matter of price lines. It is my opinion that we should continue to use odd prices in many instances, but that the practice of using odd prices almost exclusively is unnecessary. . . . May I say that, in my opinion, the excessive use of odd prices is on the wane.¹

The Control of Resale Prices.—Some manufacturers of trade-marked, patented, and advertised merchandise attempt to dictate the prices at which the wholesaler can sell to the retailer, and the prices the retailer can charge the consumer. The large-scale retailers—department, mail-order, and chain stores—have consistently opposed such practice. The federal laws as they now stand make it difficult for a producer to control, legally, the resale price of his products after title has passed to the merchant. The manufacturer can refuse to sell any more goods to the merchant if he refuses to maintain the prices suggested. The dealer in most cases, however, can secure his supplies indirectly if the producer refuses to sell to him directly. The courts have rather definitely decided that the producer cannot enter into a legally enforceable contract with merchants to maintain resale prices, neither can he use intimidation, force, threats, or other coercive methods. He can suggest, exhort, and, as a last resort, refuse to sell. A manufacturer can, however, enter into exclusive-agency contracts. In these instances the only recourse for the manufacturer against an agent who does not maintain the resale price is to cancel the exclusive-agency contract. If merchandise is consigned to the dealer, so that the title still remains with the producer, he is, of course, free to dictate the resale price.

A number of bills have been introduced in Congress for the purpose of legalizing the use of contracts for price maintenance. To date, however, none of these bills has become a law. A few states have enacted laws that permit a limited amount of price fixing of identified merchandise by the manufacturer.² The unpopularity, among consumers and large-scale retailers, of the price-fixing features of the codes suggests that the state laws may encounter considerable opposition.

Merchandise that is highly perishable, possesses a strong style element, is not identified and advertised, or is used as a raw material

¹ PETER, NEIL, President, James McCreery & Company, New York, "Do 'Odd' Prices Really Sell Goods?" *Advertising and Selling*, p. 46, Oct. 11, 1934

² The number of states that permit some form of contract providing for the maintenance of resale prices between manufacturer and merchant increased to ten during 1935.

furnishes little opportunity for resale price maintenance. The desire for price maintenance came with the development of nationally advertised merchandise. The manufacturers built up a consumer demand for their products through advertising, then found the department stores, mail-order houses, and, later, the chain stores using these well-known and standardized products as loss leaders.¹

The small-scale independent merchants frequently refuse to stock the goods featured by the price cutters. The manufacturer is forced, under the circumstances, to choose between the large-scale price cutter and the small independent. Until the rapid growth of the chain stores, the independent retailer furnished the manufacturers the best sales outlets. The large-scale retailers have now become such an important factor in marketing many lines of products in some districts that the manufacturer cannot afford to ignore them. The development of private brands by wholesalers and retailers has made it more difficult for the manufacturer to insist on price maintenance.

Price maintenance seems to be favored by the small independent retailers, wholesalers, and the manufacturers of certain nationally advertised goods. The manufacturer spends large sums of money in sales-promotional activities in order to create consumer recognition, acceptance, and perhaps demand. He believes this goodwill for his product on the part of the consumer and of the trade entitles him to preferred treatment. Some manufacturers argue that price cutting tends to drive out the independent retailer and to promote monopoly in the retail field. The refusal of independent retailers to stock merchandise used as loss leaders by large-scale retailers tends to reduce the available retail outlets and thus may materially reduce the manufacturer's volume of sales.

Liberty in setting resale prices by the retailer is advocated by large-scale retailers, consumers, and a large number of manufacturers. Some of the arguments against price maintenance are that the dealer who buys merchandise has the right and should be permitted to set the resale price at any figure he thinks best; the retailer is usually forced to pay a price high enough to remunerate the manufacturer for the expenditures he has made to create goodwill for his product, and there is little evidence that goodwill for an article and its manufacturer is destroyed because the product is used as a loss leader or sold at cut-rate prices; reduced prices frequently are the result of more efficient buying and selling methods,

¹ "It is hard to justify the loss leader in terms of economy and efficiency. It is a device, not of the technology of merchandising, but of the business struggle for customers; it makes its appeal not by lowering cost, but by selling below cost. The rivalry between retailers should be based upon practices which promote economy in merchandising, not upon sheer financial strength or predatory tactics." *The Blue Eagle of the N.R.A.*, May 6, 1935.

and the consumer is thus permitted to share in the benefits of these improvements; only inefficient and high-cost merchants are eliminated. Price maintenance tends to restrict competition to service only. The very fact that certain interested groups want price maintenance indicates that these controlled prices will be higher than competitive prices, thus virtually taxing the consumer and penalizing the efficient merchant. The practice may tend to promote monopoly control by an industry rather than by an individual firm when supported by governments. Price fixing schemes tend to reduce sales or to prevent them from expanding.

The following editorial quoted from the *Retail Ledger* indicates the attitude of the various parties interested in resale price maintenance. The percentages are somewhat misleading due to the fact that only a small number of the questionnaires mailed out by the Federal Trade Commission were returned. This may indicate a rather widespread lack of interest in the attempt to secure the proposed legislation.¹

EFFECT OF CUT PRICES ON VOLUME OF SALES

One of the most significant developments in connection with the investigation of resale price maintenance undertaken by the Federal Trade Commission is the fact that only 53.3 per cent of the manufacturers who replied to the commission's inquiry stated definitely that, when dealers cut the price of a manufacturer's product, its sales volume is impaired. That an increase in volume is the result of such price cutting is the opinion of 7.5 per cent of those who replied, while 39.2 per cent of the answers to the price questionnaire stated that, so far as they could tell, a reduction in price had no appreciable effect on their volume.

It is notable, however, that there was a marked difference in percentages according to the different manufacturing groups, 60 per cent of the tobacco manufacturers, for example, maintaining that dealer price cutting was not reflected in sales volume while, strangely enough, the shoe manufacturers concurred in this viewpoint. The group voting most strongly against dealer price reductions on the ground that they restricted sales were the manufacturers of watches, clocks, and silverware, more than half of the makers of machinery and automobiles being of the same opinion.

The effect of cut prices on competing products, so far as the sales volume of the individual manufacturer was concerned, is another matter in which there appears to be a marked lack of uniformity of opinion. Forty-five per cent of those who replied stated that their sales decreased when dealers reduced the cost of competing products, 19.3 per cent reported that such price cutting did not decrease their sales and 35.6 per cent made no definite answer to this question.

¹ The proportion of data secured by the Federal Trade Commission from a questionnaire mailed out to a large number of merchants and manufacturers in an attempt to learn their attitude toward an effort to legalize price-maintenance contracts was as follows: Only 2,334 retailers out of 36,000 replied; 325 out of 2,325 wholesalers; 847 out of 6,000 manufacturers; 801 out of approximately 10,000 professional people. *House Document 546, Part I.*

If these percentages are representative of the average feelings in the manufacturing field, it would appear that the proponents of price-maintenance legislation have lost much of their strongest argument.

Professor Nystrom contends that "price fixing, the regulation of discounts and terms, the prohibition of consignment selling and setting up of arbitrary classifications of customers with price discriminations based on politics, rather than economics, are not fair trade practice provisions. They do not facilitate competition."¹

*An Illustration of "Senseless" Price Cutting.*²—On May 30, 1935, following the Supreme Court's decision on the N.R.A., some retailers in Los Angeles cut prices without regard for wholesale costs. The wholesale cost of sugar in cloth bags, for example, was 10 pounds for 52 cents, yet retailers offered 10 pounds for 22 cents; 1 pound of butter was offered at 15 cents a pound; two dozen lemons, for 5 cents; 10 pounds of potatoes, for 10 cents; standard brands of coffee, for 21 and 22 cents a pound; Old Dutch Cleanser, at 5 cents. On Friday, May 31, one large chain advertised that any of its stores would buy for cash 10 pounds of sugar in cloth bags at 45 cents, and 10 pounds of sugar in paper bags at 44 cents; butter at 29 cents a pound; and Old Dutch Cleanser at 6 cents a can. People rushed to buy from the price cutters, and then took the merchandise to the other store and realized a profit. Men and women bought automobile-loads of the merchandise and carried it to the buying store.

The prices offered were slightly below the wholesale price, so this firm was in a position to make a profit at the expense of its shortsighted competitors. Many stores are reported to have lost from \$5,000 to \$10,000 during Friday and Saturday of the sales. The price cutting, consequently, lasted only a few days. This practice seems to be one effective method of stopping such unreasoned action, and no code or constitutional amendment is needed to make it effective.

How Serious Is the Practice?—The true situation seems to be that both sides have over-emphasized the importance of price cutting, and legalized resale price maintenance. The damages done by price cutting are not so serious, nor are the supposed benefits (or evils) of price maintenance so great as is claimed. If a law permitting contracts for controlling prices were passed, many manufacturers would find it inadvisable to insist upon them if large and important retailers refused to sign. The attempted use of the contract would likely encourage the development of a large number of private brands put out by large-scale retailers and wholesalers; more purchases of unbranded and non-advertised goods would result. Prices could not remain far out of line for any considerable time because of competition among producers and among merchants.

¹ NYSTROM, P. H., *Trends Dangerous to Consumers Under the N.R.A.*, p. 28.

² Reported in *Advertising and Selling*, June 20, 1935, By D. L. Teilhet.

When a company reduces prices well below the cost of production for the purpose of driving out competitors, the competitors have legal recourse under present laws. Such practice has been held as unfair. The proponents of price maintenance should not lose sight of the fact that all merchants do not have the same costs of selling. Some operate on a cash basis, and some on a cash-and-carry basis; others sell on a time-payment plan, deliver, and furnish other expensive services. These added costs must be covered by the resale price. The consumer who does not want to receive and pay for these extras should not be forced to do so.

The practice of arbitrary price discrimination followed by some producers is not justified on the basis of sound business policy. It is not necessarily desirable that all retailers, for instance, pay the same price for their merchandise; neither is it necessarily desirable that all retailers sell at the same price.¹ Where there are differences in the prices paid and received there should be sound reasons. Prices based on the volume of purchases, when such purchases actually reduce the costs of production or marketing, or both, are economically justifiable. A resale price based on actual costs of selling and an acceptable net profit per unit should not be condemned. Such instances do not represent predatory price discrimination. Prices quoted just to get the order or make the sale, irrespective of costs of merchandise, of selling, or of an acceptable net profit, are usually socially and economically objectionable.

The codes provided, actually, for "price fixing" in only a few industries, *viz.*, oil, coal, copper, and lumber. It will be noted that these industries are all operating in the field of natural products, consequently they may be regarded as special situations. Only 248 of the first 500 codes provided for the "open-price" plan, complete or modified. Thirty-eight codes contained other provisions pertaining to price. Under the open-price plan the practice of secret price cutting is difficult. Competition is brought out in the open. There is a tendency toward price stabilization, but not price freezing because any member of the code can file new and higher or lower prices at any time.¹

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¹ Cf. Editorial, *Business Week*, Oct. 13, 1934.

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Questions for Discussion

1. What is the meaning of each of the following terms: value? money? medium of exchange? standard of value? price? normal price? market price? exchange value?
2. How does price direct the "apportionment of wealth"? Give illustrations.
3. Are prices "causes" or "effects," or both causes and effects? Justify your answer.
4. Demonstrate by concrete examples how prices affect: (a) production; (b) costs; (c) supply; (d) demand.
5. What is meant by the terms: marginal costs; bulk-line costs; average costs; marginal vendibility?
6. Demonstrate how prices are affected by: (a) increased and decreased supplies; (b) increased and decreased demand; (c) monopoly control by a single firm; (d) by an industry.
7. What factors limit a monopoly in the "full enjoyment" of its monopolistic powers?
8. A manufacturer of a patented article selling at \$5 cannot meet the demand with his existing plant. He is debating whether to extend his plant or to raise his price. Would he be aided in reaching the wisest decision if he knew what elasticity there was in the demand for his product? Justify your answer.
9. "They (the manufacturers) have evidently discovered a mechanism which enables them to lift their products outside of ordinary competition and to hide the fact that they are not giving to the consumers of the nation the benefit of those lower prices to which the general progress in production entitles them." What is this mechanism? Why has this mechanism been developed?
10. State the arguments *for* and *against* the policy of fixed price differentials between wholesalers and retailers; among the different kinds of retailers.
11. Do you believe price differentials should be based on: (a) functional classification of buyers; (b) quantity of purchases; (c) quantity and quality of services rendered, or on some other basis? Justify your answer.
12. Why did the following price policies and practices develop: (a) one price to all customers; (b) basing-point system; (c) charging what the traffic will bear; (d) following the leader; (e) following custom; (f) odd prices? Under what conditions and by what marketing agencies is each policy used?

13. Summarize the arguments *for* and *against*: (a) retail price maintenance; (b) the use of loss leaders; (c) advertising allowances. Who, generally speaking, favors and who condemns each practice?

14. "In the final analysis the prices which sellers can charge are determined in the retail market." Do you agree? Justify your answer.

15. "The growers' cost of production does not directly determine the prices of the great farm staples." Why? Do you think costs should determine the price? Justify your answer.

16. How do price policies affect the area of the market; the channels of distribution used?

17. What are the factors usually considered in pricing a product? Discuss the importance of each factor.

a. What is the difference in the ways in which the prices of production goods and consumer goods are determined?

b. "The retailers of strictly shopping lines make greater efforts to keep their prices in line with competitors than do the retailers of convenience lines." Why? Is this what you would expect?

c. "The prices of specialty goods show a wide range for the different lines." How do you account for this? Give illustrations.

d. "The bane of the produce market is the extreme instability of prices." What are the factors in price making for such perishable goods?

e. How are the prices for each of the following forms of services determined: unskilled labor, skilled labor, professional services, transportation services, entertainment services?

18. What is the meaning of the following terms: "quantity discount," "trade discount," "cash discount," "f.o.b. sales," and "3, 10, net 60"?

19. What are the conditions which tend to keep actual market prices from coinciding with the normal price?

20. Suppose we could by some means stabilize the "general price level," would this accomplishment necessarily solve the dilemma of price fluctuations of individual products? Justify your answer.

Assignment

1. Problem 3, p. 643. Tasker Brill Company—Price Simplification.
2. Problem 1, p. 718. Dennison Manufacturing Company—Discount Policy.
3. Problem 2, p. 673. Dexter Machinery Company—Relation of Overhead Expense to Prices.
4. Problem 1, p. 675. Pittsburgh Basing-point System.
5. Problem 3, p. 761. Wentworth Food Company—Advertising Resale Prices.
6. Problem 2, p. 665. Granger Baking Company—Relation of Cost to Price.

CHAPTER XVI

FINANCING MARKETING ACTIVITIES

Purpose of this chapter: To determine the nature of the demand for marketing finance; to survey the different kinds of credit; to note the characteristics of each; to analyze some of the more important marketing problems involved in financing selling and buying.

We have discovered in our previous discussions that the ability to buy depends to a considerable extent on the purchasing power of the individual, the firm, the institution, or other would-be purchaser. Purchasing power, in the long run, comes, generally speaking, through the production and exchange of goods or services for money or its equivalent. Money or its equivalent, credit, is the lubricant that facilitates the operation of the marketing machine. Purchasing power may be transferred, however, from one party to another through the use of credit. Governments, business firms, and various types of institutions may borrow on the basis of their own resources, and lend the funds so secured to other governmental units, business firms, institutions, and individuals who use the credit or money to buy and sell goods and services, and to liquidate old debts.

The Demand for Credit in Marketing.—The marketing process is kept in motion through the use of money and credit. The buyer must pay a price for the goods and services he consumes. If he does not own the cash, he must borrow, or the seller must extend credit to him. Under either condition the purchaser enjoys the use of the goods immediately and pays later. He must pay the entire amount at some stated future date or pay on a partial payment or installment plan.

The financial resources of the producer, as stated previously, frequently determine the method of marketing used. A large number of consumers, merchants, and producers confine their purchases to those sellers who can and will give them credit. The marketing of urban real estate, farms, agricultural products, machinery used on the farm; equipment used in the home; industrial equipment, supplies, raw materials, and finished goods; rolling stock of railroads; and the equipment of other utilities must be financed. Wholesalers and retailers typically require financial assistance in some form.

The length of the production process in many industries introduces a long-time interval between the purchase of raw materials and the sale of

the finished product. The farmer, for instance, must be supplied with land, machinery, seeds, live stock, and his own food and clothing before he can produce and sell his crops. He typically has a small amount of money, but usually not enough—so if he is to produce, he must utilize credit. When he buys his farm he generally makes a down payment of from 10 to 75 per cent of the purchase price and gives a mortgage as security for the remainder; the purchase of his machinery and live stock may be financed by giving a promissory note which may or may not be secured, depending on his financial standing. Typically, he secures his notes by a chattel mortgage on his machinery, crops, and live stock, or by the signature of a neighbor. His food and clothing may be purchased on open account from a local merchant. The farmer, in all these transactions, is "buying on credit" so as to facilitate his *production*. The dealers selling to him, however, are interested primarily in *marketing*. This example illustrates how artificial is the attempted distinction between so-called forms of *production* and *marketing* credit.

Industrial concerns frequently issue long-term bonds to secure funds with which to construct more buildings and to buy new machinery. The manufacturer must wait a long time before he secures the return of the full value put into the buildings and equipment. When he buys raw materials, however, he has to wait only long enough to turn them into finished products, sell them, and collect the sales price. This period of waiting may be only a few days for some service firms, such as public utilities, to several months for goods sold on the installment plan.

When the producer attempts to finance the short-time phase of his production or marketing activity, he may establish a line of credit at his bank, or issue short-term promissory notes and sell them through commercial paper houses, which in turn sell them to banks and individual capitalists. The large packers, for instance, finance their large-scale purchases of live stock and their huge inventories of semimanufactured and manufactured products¹ largely by the sale of short-term commercial paper.

If credit were not available for production and marketing under the above-mentioned conditions, the scale of operation would probably be reduced, or the opportunity for newcomers to enter such enterprises greatly limited, and the activities confined to a few fortunate concerns that are financially strong enough to operate without credit. Such a situation would tend to breed pernicious monopolies. The probable effect of operating, on a cash basis, enterprises whose production and

¹ The packers at certain times have large sums of money invested in meat which is being changed into bacon, hams, and pickled meats. Their inventories of lard and fresh meat also represent huge investments. The seasonal character of production and of demand makes financing by commercial paper advisable.

marketing processes consume a long period of time would be a great increase in the ultimate cost of the finished goods.

Seasonal Factors.—Seasonal factors in both production and consumption create a demand for credit. Grain, cotton, live stock, and many other agricultural products reach the market in large quantities during short periods of time. The non-perishable group is processed at a comparatively regular rate which corresponds roughly with the rate of consumption throughout the year. The perishable group has to be processed immediately and held until consumed. The farmer does not want to wait for his pay until the goods manufactured from his products pass into the hands of the consumer. If such were the case it would, in fact, work a great hardship on the agricultural industry. Elaborate and extensive financial machinery has been developed so that the farmer can receive cash immediately; he is thus enabled to liquidate the indebtedness he has contracted with his local bank and merchants. The Federal Farm Board and more recently the Farm Credit Administration made it possible for the farmers, through their cooperative associations, to receive credit to finance the marketing of their wheat, cotton, butter, cheese, and fruits. Other agencies, previously mentioned, also assist in financing the sale of these and other agricultural products.

The rate of consumption of many products reveals well-defined seasonal trends. Certain merchandise and services find ready sale in the spring and summer, and others in the autumn and winter. Few of these products can be manufactured just as they are wanted by the consumer. They typically are manufactured at a more even rate throughout the year. The excess production during the off season is stored, and later shipped out during the period of excess demand. This situation is well illustrated in the automobile and clothing industries. This manufacturing and storing for future sale requires financing. Some one has to wait and assume risks during the interval if the user is to be able to supply his wants at the proper time. The consumer does not want to, and, in fact, probably could not, advance the purchase price several months before he is to use the merchandise. Merchants and manufacturers would not find it profitable to attempt to finance these peak seasons with their own funds, because at other seasons they would have a large amount of idle funds. They would then have to divert their attention from manufacturing and marketing to the problems of finding remunerative employment for their surplus money. It is more economical to borrow from the specialized credit agencies during the peak periods. Commercial banks and other financing agencies typically supply this important service.

Credit, the Consumer, and the Producer.—The methods used in financing marketing transactions are of interest to the consumer because they affect the prices he must pay and at the same time they afford him a means by which he can secure the commodities he desires; to the producer the methods are important because his ability to operate at a profit may depend upon whether he can finance the purchase of raw materials, services, and equipment, and the sale of the finished goods. The opportunity to furnish all of those services usually performed by wholesalers and retailers may depend in whole or in part upon their ability to finance their purchases and sales. The producer may finance the wholesaler and the retailer, the wholesaler may finance the producer or the retailer, and the retailer may finance the manufacturer, the wholesaler, and the consumer.

The use of credit may be justified on a number of social and economic grounds. Credit permits an individual or a family to enjoy the ownership, possession, and use of a home, household equipment, a car, musical instruments, clothing, and many other articles before sufficient funds have been saved with which to pay for these commodities. A consumer may not be able to pay cash for the necessities of life at certain times because such unfortunate circumstances as illness, accident, and unemployment have temporarily reduced his purchasing power. When he is again gainfully employed, he can satisfactorily liquidate any reasonable amount of indebtedness contracted during the unemployed period. The sum total of human satisfaction and welfare may thereby be greatly increased through the wise use of credit.¹

Some consumers and producers find their income unevenly distributed throughout the year. They need to consume in the present but their income will not be available until sometime in the future. Some workers are paid every two weeks; many office workers are paid only once a month; many farmers receive the major portion of their annual income during a short period at harvest time. Some of these groups find it is a great convenience to be able to consume first and pay on or after payday, rather than to save enough money from the last income date to pay cash for all purchases made before the next receipt of funds.

People who have adequate funds to pay cash for consumption purchases frequently find it more convenient to have the purchases "charged" and then pay the entire amount with one check on the first of the following month. Grocery, department, and many other types of retail stores furnish this form of service to their customers. This

¹ It should be recognized that certain abuses of credit may lead to the opposite results.

practice speeds up the sales transaction, reduces the time required to wait for change, and removes some of the risk involved in carrying around large sums of money. At the end of the month the buyer receives an itemized statement of his purchases for the period, which aids him in keeping account of his expenditures and cost of living.

Credit makes it possible for men of ability but with limited financial resources to start in business. People with small and large savings but with little business ability and experience can loan their funds to the honest and capable men. Much of our industrial development has been made possible through this utilization of credit. These people who borrow money to start and to expand business enterprises use the credit so obtained to buy cement, steel, machinery, agricultural products, natural products, labor, merchandise, and the other commodities of commerce.

Sales Promotion.—Credit is rather widely used as a form of sales-promotion. Competition among sellers frequently leads to unsound and antisocial methods. Some producers and merchants appear to be selling credit as well as merchandise. When the seller places the major emphasis upon the "attractiveness" of the credit terms, he distracts the attention of the purchaser from the quality of the goods and the services to be derived therefrom. The consumer, for instance, may be led to pay such a high price for the credit service that the utility derived from the merchandise may be far below what may reasonably be expected. A social injustice may therefore result with injury to the producer and merchant as well as to the consumer.

Methods, Institutions, and Instruments.¹—There are two major methods by which the financing of marketing is administered. The seller, who may be the producer, wholesaler, or retailer, may extend or grant credit to the buyer, who may be a manufacturer, farmer, mine operator, merchant, or consumer. The seller may be able, because of his own financial strength, to grant this credit without the assistance of others, or he may have to go to some financial institution for aid. The buyer, however, may be able to finance his purchases in such a manner as to pay cash to the seller. His financial resources may be such that he can buy on a cash basis without resorting to independent finance agencies; frequently, however, he finds it necessary or advisable to use the services of commercial banks and other financing institutions.

Institutions.—The basis of the financial structure used in financing marketing transactions is the commercial bank and the Federal Reserve System. Other more highly specialized agencies engaged in financing

¹ For a more extended discussion of this topic, consult some standard text on money and banking or credits and collections; e.g., H. G. Moulton, *Financial Organization of Society*, and T. N. Beckman, *Credits and Collection in Theory and Practice*.

sales are financing companies,¹ of which the automobile and household finance companies² are probably the best known, cattle-loan companies, federal land banks, federal intermediate banks, national farm loan associations, joint stock land banks, mortgage companies, insurance companies, Morris Plan banks, building and loan companies, commercial paper houses, bond houses, investment banks, and the historic pawnshop. A number of marketing middlemen, factors, cold-storage firms, warehousing companies, and elevator and commission firms provide a financing service in connection with the performance of their regular buying, selling, storage, and other marketing services. The wholesalers and retailers, as was stated previously, are important cogs in the credit-granting machinery.

The Human and Economic Elements.—Credit is based largely on trust and confidence—trust that the debtor will be *willing* to pay, and confidence that he will have the *ability* to pay at the appointed time. Efficient methods and agencies have been developed for the purpose of investigating the character, business ability, professional and social standing, employment, income, property, liabilities, and other factors that experience shows may affect and determine the applicant's willingness and ability to pay.

Credit Instruments.—Many sales are made on open account, in which case no formal evidence of the debt is used and no security is required.³ This procedure is followed when the buyer is well known, the amount of the purchase is not large, and the credit period is relatively short. Table 76, page 523, indicates the importance of this form of credit. Retailers and wholesalers as well as consumers buy a large amount of their merchandise on open account. When some formal document is issued as evidence of the credit transaction, security may or may not be demanded. This depends upon the financial position of the buyer, the amount of the credit transaction, and the policy of the seller.

Among the more commonly used instruments of credit is the widely used bank check, which is an order to a bank in which the drawer has a credit balance to pay on demand to bearer or to some designated person, a certain sum of money. To eliminate some of the uncertainty con-

¹ The sources of credit for the finance companies are their own funds, lines of credit established with banks, direct sale of short-term notes to banks and to commercial paper houses, sale of long-term notes to the public, and open-market sale of drafts, bills, and banker acceptances growing out of export transactions.

² Household finance companies loan funds to the limit of \$300 on the promissory note of the consumer, secured by a lien on household goods. The period of the credit may be for as long as twenty-four months with payments on a monthly basis.

³ These credit sales appear on the books of the seller as "accounts receivable"; the buyer receives a charge slip and is given a statement of his indebtedness at regular intervals.

nected with the use of checks, the buyer may be asked to use a special form, such as a *certified* or a *cashier's* check.

Another commonly used credit instrument is the promissory note. It is a written promise of the drawer to pay to the drawee a definitely determinable amount of money at a certain time. Interest may or may not be charged. If the willingness and ability to pay are in doubt, security may be required.

Other specialized forms of credit instruments are drafts, bills of exchange, trade acceptances, banker's acceptances, postal and express money orders, traveler's checks, and some forms of currency. Bonds are used by corporations when the credit period is for several years.

Security for Credit Transactions.—The forms of security used are many and varied.¹ The bank, for instance, may require the holder of a check to be identified, or ask him to have some one whom the officers know to be reliable to endorse the check, thus guaranteeing ultimate reimbursement to the bank. The person accepting a promissory note may require the giver to have one or more other individuals sign it. These added signatures, provided the signers are people of character and means, increase the probabilities of payment at the stated time. The goods themselves may be used as security. Agricultural products may be loaded on a car to be shipped to a firm in the central market; the shipper can draw a draft on the consignee for the value of the shipment, then attach the bill of lading, take the two to his local bank and secure funds to the amount of 75 to 90 per cent of the face amount. Warehouse receipts play an important part in the financing of grain, cotton, coffee, eggs, and many other commodities. Promissory notes are sometimes secured by a mortgage on the goods sold, or on some other property owned by the person receiving credit. The mortgage and land contracts are important forms of security used in financing the marketing of real estate. The chattel mortgage is used extensively in the marketing of automobiles; furniture; live stock; and store, farm, factory, and household equipment. Bonds and notes of corporations are secured by mortgages on real estate, buildings, and equipment, and by the use of collateral securities, such as stocks and bonds.

Bills of exchange are better credit risks after they have been "accepted" by the party upon whom they have been drawn. After a bill drawn by an individual upon another individual or firm in the course of a commercial transaction has been accepted by the drawee, it is known as a *trade acceptance*. A similar bill drawn on and accepted by a

¹ Credit may be based on possession of an article already owned by the borrower, or it may be advanced so that the debtor may gain possession of the article upon which credit is granted. This plan is followed in the installment method. In the latter instance the personal factor, the moral hazard, is an important element.

bank is called a *banker's acceptance*. These two forms of credit instruments are among the safest used in business transactions.

A buyer who is not well known in the foreign market may arrange for a *letter of credit* issued by his own bank. This document authorizes the seller in the foreign country to draw a bill of exchange, up to a certain amount, against the bank, to be charged against the account of the local importer. This is a simple means whereby the bank virtually guarantees payment of the bill. The bank protects itself by investigating the character and business standing of the purchaser, and by having the export bill of lading and other documents made out to it. It need not turn over possession of the goods to the buyer until it is satisfied that he can and will pay.

Three Principal Kinds of Credit.—The different varieties of credit may be classified on a number of bases, thus: on the basis of the length of the credit period there is demand, short-time, and long-term credit; on the basis of the commodity used as a factor of security there is live-stock, grain, real-estate, produce, and collateral credit; on the basis of the institutions and individuals that either give or utilize the credit there is banking, public, government, industrial, mercantile, and individual or personal credit; on the basis of the use to which the funds borrowed are put there is production, commercial, and consumption credit.

The classification on the basis of *use* seems to serve our purpose best. *Production* credit is extended typically over a long period, and is used in marketing capital equipment, such as land, buildings, and machinery. A number of years usually elapse before such commodities "pay for themselves." *Commercial*, sometimes called mercantile, credit is typically used for short periods and is usually based on a sale of merchandise. This form of credit is used extensively among producers and the various types of merchants. The length of the credit period in many instances is long enough for the purchaser of the merchandise to sell the goods and pay off the indebtedness before the due date. *Consumption* credit is used to facilitate the sale of goods to the consumer. It is typically for short terms and the security is based largely on the honesty and integrity of the individual buyer. The purchase of a home, however, is usually financed on long-term credit. Open-account and installment credit are widely used subdivisions of both commercial and consumption credits. The commercial and consumption forms of credit, because of their importance in marketing, deserve a more extended discussion.

Commercial Credit.—Commercial credit may be thought of as that form of credit which is used to secure merchandise for resale. The goods themselves are frequently used as part of the security; promissory notes, drafts, bills of exchange, and checks are some of the more com-

monly used credit instruments. The merchandise may be purchased on open account, the indebtedness being liquidated in a lump sum, or it may be paid for by some partial-payment or installment plan.

The Importance of Wholesale and Retail Credit Sales.—No one knows the volume of credit sales made during a year in the United States. Various estimates which may be considered fairly reliable have been made from time to time by different individuals and agencies.¹

Table 75 serves to illustrate the importance of credit sales in the wholesale field. More than 87.34 per cent of the total reported business of tire and tube wholesalers in 1929 were credit sales, and 97.29 per cent of the total were indirect; 86.30 per cent of the total sales of 10,518 dry goods and apparel wholesalers doing a business of almost \$6,000,000,000 were on credit, and more than 97 per cent of the sales were indirect; 81.24 per cent of the business of 1,071 wholesalers operating in the general dry goods field was on a credit basis, and 96 per cent of the goods were sold by the indirect method; 90.35 per cent of the more than \$2,600,000,000 business done by 2,696 piece goods wholesalers was on a credit basis, 51.76 per cent of the sales were direct to industrial users, and 48.10 per cent were indirect; 88.52 per cent of the sales of 1,901 electrical goods wholesalers, including those handling appliances, who secured a volume of business in excess of \$1,363,000,000 was on a credit basis, 61.98 per cent of the total was direct to industrial users, and 37.34 per cent was indirect; 84.36 per cent of radios and radio parts were sold on credit, and 95.68 per cent of the total sales were indirect; 82.02 per cent of the sales of wholesalers of house furnishings were on credit, and almost 97 per cent of the total sales were indirect; 84.16 per cent of the sales of general line hardware and 80.05 per cent of the sales of specialty hardware wholesalers were on credit, and 80.27 per cent and 64.89 per cent of the total sales respectively were indirect; about 45.85 per cent of the total sales of 6,900 general line grocery wholesalers with a volume of business in excess of \$5,200,000,000 were on credit.

Other kinds of wholesale businesses whose credit sales exceeded 50 per cent of their total sales were: drug—both special and general lines; fish and sea food; meat and meat products; furniture; lumber and building material; house furnishings; musical instruments and sheet music; jewelry; commercial equipment and supplies; professional equipment and supplies; service equipment and supplies; metals and minerals, except petroleum and scrap; coal; paper and paper products; stationery and stationery products; books, periodicals, and newspapers; textiles and textile materials other than dry goods.

¹ A summary of some of these estimates is given in Seligman's "*The Economics of Installment Selling*," Vol. I, Chap. V. Some estimates place the volume of wholesale and retail credit business, including checks, as high as 90 per cent of the entire volume.

Those wholesale business firms with less than 50 per cent of their total sales on credit in 1929 were: petroleum and petroleum products; fresh fruits and vegetables; grains; cotton; electric refrigerators, and

TABLE 75.—CREDIT SALES IN THE WHOLESALE FIELD, BY KIND OF BUSINESS
United States—1929

Kind of business	Number of establishments	Net sales	Per cent of credit sales
Automobiles and other vehicles.....	743	\$1,226,346,751	3.37
Tires and tubes.....	655	386,603,407	57.34
Drugs and drug sundries (general line).....	638	575,099,513	72.10
Drugs and drug sundries (specialty).....	849	193,898,438	69.14
Dry goods and apparel.....	10,518	5,949,916,877	86.30
Dry goods—general line.....	1,071	889,508,439	81.24
Piece goods.....	2,696	2,624,280,838	90.35
Electrical goods (including appliances).....	1,901	1,363,595,815	88.52
Radios and radio equipment.....	806	491,821,311	84.36
Refrigerators (electric).....	172	104,292,238	47.32
Cotton.....	5,234	3,061,609,905	5.78
Grain.....	12,245	4,001,105,461	12.09
Fish and sea foods.....	1,448	243,681,576	58.53
Fruits and vegetables (fresh).....	11,194	3,252,975,872	45.52
Meats and meat products.....	3,605	3,102,286,136	68.30
Furniture.....	1,146	344,630,426	74.59
House furnishings.....	1,653	591,179,409	82.02
Musical instruments and sheet music.....	178	58,242,211	70.06
General merchandise.....	370	596,065,896	66.61
Groceries (general line).....	6,900	5,203,417,138	45.85
Hardware (general line).....	1,227	754,593,635	84.16
Hardware (specialty).....	562	111,564,697	80.05
Jewelry.....	1,925	450,088,560	73.75
Lumber and building materials.....	5,513	2,144,052,240	73.25
Commercial equipment and supplies.....	1,804	250,929,433	66.25
Farm machinery and equipment.....	560	385,838,429	78.44
Manufacturing, mining, and drilling machinery, equipment and supplies.....	6,142	1,648,879,563	79.93
Professional equipment and supplies.....	1,000	207,815,659	74.29
Service equipment and supplies.....	1,439	201,098,108	71.78
Metals and minerals (except petroleum and scrap).....	3,620	5,600,700,719	79.14
Coal.....	1,343	1,160,290,340	82.44
Paper and paper products (general).....	1,568	679,013,910	80.04
Paper and paper products (specialty).....	584	307,812,990	79.86
Stationery and stationery supplies.....	719	113,567,706	72.48
Petroleum and petroleum products.....	23,008	3,365,662,531	41.23
Plumbing and heating equipment and supplies.....	2,786	819,666,923	77.28
Heating equipment and supplies.....	635	117,921,101	54.46
Tobacco and tobacco products.....	2,016	1,691,172,877	78.35
Books, periodicals, and newspapers.....	636	203,040,817	61.94
Textiles and textile materials (other than dry goods).....	1,299	831,883,779	83.18

¹ Compiled from "Wholesale Distribution," U.S. Department of Commerce, Bureau of the Census, p. 78, 1930.

automobiles. Only 3.37 per cent of the \$1,225,000,000 volume of business done by 743 automobile and other vehicle wholesalers¹ was reported as on a credit basis. This situation is due to the fact that the

sales are financed chiefly through specialised credit companies. These companies immediately accept the promissory notes given by the final buyer to the dealer and pay the automotive retailer the unpaid balance, who then pays cash to the wholesaler, who in turn pays cash to the manufacturer. Thus credit sales among the wholesalers in the automotive field are reported at a very low figure, yet a large proportion of retail sales, as we shall note later, are on a credit basis.

Factors That Determine the Granting of Commercial Credit.—Whether a particular firm will sell or buy its merchandise on credit may depend on a number of factors. Competition perhaps is one of the most important determining factors. The greatly increased production capacity of manufacturers has caused them to offer liberal credit terms in an effort to induce wholesalers and retailers to handle their merchandise. Some retailers are so weak financially that they cannot borrow from the banks, and, since they do not have capital of their own, some manufacturers and wholesalers are willing to provide them with a stock of merchandise, finance the purchase of equipment, and guarantee the payment of their rent. This is done sometimes to secure new outlets and to retain old ones. Independent retail outlets are frequently financed by such producers as candy manufacturers, oil refiners, tire and automobile manufacturers. The last three sometimes finance wholesale distributors. There appears to be ample evidence to support the statement that competition among manufacturers and wholesalers has been responsible for establishing and maintaining, for a time, retail outlets whose existence was not economically justified.

The Department of Commerce report on the credit situation in Louisville illustrates the unbusinesslike methods followed by some wholesalers in extending credit to retailers.¹ One grocer, for example, notwithstanding the fact that he had failed in another line of business, that one wholesale establishment had collected from him by the magistrate since he had been in the grocery business and another one had threatened to sue him, and that bills to other wholesalers were from 30 to 90 days overdue, was still buying merchandise on credit from wholesalers. Another grocer failed, owing more than fifty creditors, most of them wholesalers, jobbers, and manufacturers. This easy credit practice is not universal among wholesalers; some are very careful in selecting their credit risks, effective in their collection methods, and consequently suffer very little from failures among retailers. The wholesaler or manufacturer who refuses to grant credit to an incompetent retailer is really doing him a favor.

Factors That Determine a Merchant's Need for Credit.—If a merchant is financially able to buy for cash, he may have little need for trade credit.

¹ *Trade Information Bull.* 627, p. 9, 1929.

If he sells for cash, his income is likely to be sufficient to make credit purchasing unnecessary. If the merchandise has a slow turnover, sells at a high price per unit, has a seasonal demand, and a large inventory has to be carried, the retailer is more likely to need financial assistance from manufacturers and wholesalers. Merchants who resell agricultural machinery, automobiles, furniture, furnaces, furs, and other similar commodities frequently make use of credit. The volume of business and changes in price levels may increase or decrease a dealer's need for financial assistance. Sales may not be so large or move so rapidly as anticipated, yet purchases of merchandise for the coming season may be necessary. Unless the merchant can turn his present stocks into cash, he may have to resort to credit when buying his next season's supply.

Cash Discounts.—Manufacturers and wholesalers may encourage prompt payment for merchandise by offering liberal cash discounts. In practically all cases a merchant can borrow money from a bank at 6 per cent interest and enjoy a big saving by taking the cash discount offered. As an illustration, consider the sales term of 2 per cent off the quoted price if the bill is paid within ten days, or the net price if not paid until the end of thirty days. If a merchant elected to pay cash at the end of ten days, he would in fact get 2 per cent return for the twenty days during which the net price would have been in operation. If the net bill came to \$1,000 he would pay only \$980 after deducting the discount. This 2 per cent for twenty days is equivalent to 36 per cent for a year. By borrowing at the bank for 6 per cent annually, the merchant would realize a profit on the financing transaction of 30 per cent. The large-scale and financially strong retailers are able to take advantage of cash discounts when offered. There are, however, many merchants whose credit is not such that they can borrow from the bank, and they do not have sufficient funds of their own. The result is they must pay the full net price. This deficiency places them in an inferior competitive situation.

The Druggists' Research Bureau found that there is a close relationship between the taking of cash discounts and success in retailing.¹ The average cash discount taken was 1.4 per cent. It was found that drugstores taking cash discounts averaged, as compared with others, 25 per cent more sales per dollar invested; 23 per cent more net profits per dollar invested in merchandise; 25 per cent more rapid turnover; lower net costs for merchandise; and lower operating costs per dollar. The merchant who is able to pay cash for his goods, even though he borrows the money from the bank by discounting his promissory note, may

¹ Quoted from *New York Journal of Commerce*, Apr. 18, 1930. This study analyzed the profit and loss statements of drugstores of "all sizes and in every section of the country, and taken at random from those submitted."

assume an independent attitude in his buying. Some manufacturers, wholesalers, and other middlemen abuse the advantage which credit granting gives them. They are able to dictate the price, quantity, and quality of purchases, often to the disadvantage of the retailer.

Financial Agencies.—The Federal Reserve System provides an extensive and effective machine for extending mercantile credit.¹ In addition to the commercial banks, there are a few important specialized financial agencies that aid in securing and granting credit for mercantile purposes. The commercial paper houses aid the large and financially strong producers. These large manufacturers, the meat packers for instance, issue their own promissory notes for a definite period of time, usually for only a few months, in round numbers. These notes are sold to the commercial paper houses which dispose of them in the open money market. The buyers as was stated previously are usually banks and individuals who know the reputation of the commercial paper house and of the issuing firm.

Cold-storage firms perform an important financing function when, in accepting eggs for storage, they advance money on them. The borrower transfers control of title to the storage company which then borrows from a bank using the title to the eggs as security.

Retail merchants may secure funds by using their accounts receivable as security. Credit companies which buy merchants' accounts receivable will advance as much as 75 to 80 per cent when the merchant makes the assignment. Usually 3 per cent is set aside as a reserve to cover costs; a reserve of approximately 20 per cent is set up to cover uncollectible items. A merchant, however, is regarded as being in a rather embarrassing financial condition when he resorts to this method of raising funds.

The following quotation describing the General Motors Acceptance Corporation plan of financing the sale of General Motors products to dealers serves to illustrate another important form of marketing finance.

THE GMAC WHOLESALE SERVICE

Under the GMAC Wholesale Plan, General Motors dealers, after credit has been established, may purchase new passenger cars and commercial vehicles direct from the manufacturing divisions of General Motors or from their distributors by paying a small amount in cash; the balance is payable as the machines are released or at an agreed date after shipment. The machines so financed may be stored in the dealer's showroom for display, in warehouses under the control of the dealer, or in public licensed warehouses under pledge of warehouse receipt.

¹ The total amount of bank credit outstanding on June 1, 1935, was approximately \$45,000,000,000. The excess reserves of the member banks of the Federal Reserve System reached a new high of \$2,425,000,000—an amount that would support almost twice the present volume of credit. *Brookmire Forecaster*, June 12, 1935.

Automobiles financed by GMAC may be shipped by freight or driven under their own power: (1) from factory to distributor or direct dealer; (2) from distributor or dealer to associate dealer; (3) from factory to associate dealer for account of distributor or direct dealer.

General Motors Acceptance Corporation retains control of the products financed until full payment is made. Arrangements are made so that a dealer may pay the amount due on a car and secure immediate release. After release the dealer has full title to the car.

The GMAC wholesale service charge includes interest to maturity and insurance protection for the dealer for his full laid down price against loss or damage arising through fire or theft.

Consumption Credit.—Credit utilized directly by consumers to aid them in purchasing merchandise and services is known as consumption credit. It is typically extended by retail merchants and various forms of finance companies. Although the installment method enjoyed a rapid growth during the decade 1920 to 1930, the informal and unsecured open-account or "book" credit remained the more important form. There is constantly outstanding in this country, according to estimate,¹ about \$15,000,000,000 in open-account retail credit. This amount will, of course, fluctuate with changes in the price level and with business conditions.

Competition among retailers sometimes promotes laxity in granting credit. That is, merchants exchange merchandise and services for promises to pay from consumers who are not able or willing to pay. The report of the credit situation among the grocery retailers of Louisville showed that an important element in the failure of this type of store was the liberal and careless credit policy followed. Whereas the average credit loss for a well-conducted grocery store was reported to be less than $\frac{1}{2}$ of 1 per cent, losses in some of the Louisville grocery stores that "were doomed to failure" ran as high as 37.4 per cent of their total sales.

Some retailers place the burden of maintaining and increasing sales volume on credit inducements to the detriment of profits and the best interests of their own creditors. They do not extend credit with discrimination or make collections in a businesslike manner. Their competitive methods tend to encourage and promote careless buying on the part of the public. Mr. Lonergan cites some interesting and perhaps unusual instances found in a Nebraska city.² One man with an income of \$90 a month was distributing his monthly income as follows: \$39 on a car, \$20 on a radio, \$15 for house rent, and he was trying to feed and clothe a family of four on the remaining \$16. People, according to the report,

¹ *Magazine of Wall Street*, pp. 364 ff., Dec. 28, 1929, quoting D. J. Woodlock, manager of the Credit Association.

² *Advertising and Selling*, p. 38, July 9, 1930.

would buy eggs on credit from the grocer, take them to a produce dealer and sell them, take the check to a filling station, cash it, use part of the money to buy oil and gas, and then spend the rest for movies and ice cream. Conditions in this town eventually became so bad that the merchants finally went to the other extreme—they went on a strictly cash basis.

The survey of the retail credit business, made by the Department of Commerce at the request of the Retail Credit Association, presents probably the most reliable retail figures available for the period covered.¹ The reports from 23,779 retail stores with annual sales of almost \$5,000,000,000 showed credit sales to be approximately \$1,864,000,000.² Cash sales amounted to 58.6 per cent of the total; the credit sales were divided into open-account sales, equal to 32.2 per cent, and installment sales, equal to 9.2 per cent. Excluding stores that do only a cash business, chain stores and mail-order houses³ department stores, the report for 10,962 stores doing a credit business in 1927 shows cash sales of 39.3 per cent, open-account sales of 48.6 per cent, while installment sales rise to 12.1 per cent. According to this classification, total credit sales account for 60.7 per cent of the selected retail volume.⁴

Table 76, constructed from data in the Credit Survey, gives more detailed figures for the twenty-eight types of retail establishments covered by the study.

The Census of American Business reported 28 per cent of total retail sales as credit sales for 1933 compared with 34 per cent for 1929. Table 77 gives the percentages of total retail sales that were reported for the different geographic divisions for the Census years 1929 and 1933.⁴

The largest percentage of credit sales in 1933 was made in Alabama where 36 per cent of the total sales were on credit; Montana was second with 35 per cent. The lowest percentage was 23 per cent; this figure was reached in New York, Illinois, and South Dakota. The census

¹ National Retail Credit Survey, Part III, *Domestic Commerce Ser.* 36, 1928-1930.

² Out of a total of 35,000 reports from retail outlets covering 33 principal groups of commodities, 75 per cent of the outlets were extending open credit, 18.7 per cent were extending installment terms, and 20 per cent sold for cash only.

³ The retail credit survey revealed that the largest percentage of credit business was done by plumbing and heating fixtures retailers, equal to 96 per cent of total sales; lumber and building material retailers were second with 92.1 per cent, and stove and range dealers with 87.4 per cent credit sales were third. The highest percentage of strictly open-credit sales was among the lumber and building material outlets equal to 90 per cent; the highest ratio for installment sales was among dealers in stoves and ranges equal to 73.2 per cent. Open-credit sales have shown a great increase both relatively and absolutely. No installment credit sales were reported by boot and shoe, grocery, bakery products, hay, grain, and feed, and drug stores.

⁴ Retail Distribution, Vol. V, Retail Credit Business in 1933, *Census of American Business*, 1933. Published May, 1935.

TABLE 76.—RELATION OF CASH AND CREDIT RETAIL SALES¹

Type of business	No. establishments	Per cent of total sales for			
		Cash	Open credit	Installment	Total credit
Department.....	892	64.5	29.8	5.7	35.5
Furniture.....	726	15.2	27.1	57.7	84.8
Women's, children's, and infants' wear.....	523	49.4	49.7	.9	50.6
Men's and boys' clothing.....	843	63.8	33.4	2.8	36.2
General clothing.....	1,616	78.4	18.0	3.6	21.6
Dry goods.....	108	61.6	38.2	.2	38.4
Fur goods.....	124	37.4	51.5	11.1	62.6
Boots and shoes.....	2,000	89.5	10.5	....	10.5
Automobiles.....	569	37.1	16.0	46.9	62.9
Auto accessories.....	678	53.8	44.5	1.7	46.2
Groceries.....	2,164	50.1	49.9		49.9
Bakery products.....	353	80.2	19.8		19.8
Radio sets and supplies.....	92	47.5	23.3	29.2	52.5
Electrical appliances.....	627	15.4	35.4	49.2	84.6
Jewelry.....	330	37.8	45.0	17.2	62.2
Optical goods.....	86	59.5	38.8	1.7	40.5
Hardware.....	706	35.2	61.1	3.7	64.8
Coal and wood.....	680	25.4	74.4	.2	74.6
Lumber and building material.....	640	7.9	90.0	2.1	92.1
Hay, grain, and feed.....	112	33.1	66.9	....	66.9
Paint, oil, and varnish.....	203	28.8	70.6	.6	71.2
Plumbing and heating fixtures and supplies.....	731	4.0	70.7	25.3	96.0
Stoves and ranges.....	22	12.6	14.2	73.2	87.4
House furnishings.....	49	23.8	70.7	5.5	86.2
Coal, wood, lumber, and building material.....	207	21.5	76.5	2.0	78.5
Drug.....	430	84.7	15.3	....	15.3
Musical instruments.....	132	17.1	28.2	54.7	82.9
Miscellaneous.....	8,136	77.8	19.3	2.9	22.2
Total.....	23,779	58.6	32.2	9.2	41.4

¹ National Retail Credit Survey, *op. cit.*

report states that the decline in credit business was most pronounced in the industrial states of the East North Central division and on the Pacific Coast. About 50 per cent of the stores reported credit sales for 1933; this group of stores accounted for about 62 per cent of total reported retail sales. Credit sales were about 28 per cent of total retail sales.¹

Table 78 gives, in some detail, information concerning the proportion of credit sales made by a selected group of businesses during the year 1933. This table indicates clearly the kinds of retail businesses that

¹ *Ibid.*

consummate a small amount of credit sales and those that enjoy a large volume. Variety, 5-and-10, and to-a-dollar stores, for example, report no credit sales; restaurants, cafeterias, and lunch rooms reported credit sales as only 2 per cent of total sales; delicatessen stores, and fruit stores and vegetable markets reported only 6 per cent and 7 per cent respectively as credit sales. Furniture stores, on the other hand, reported credit sales as amounting to 69 per cent; household appliance stores reported 72 per cent; and lumber and building material dealers reported 67 per cent.

TABLE 77.—PROPORTION OF CREDIT SALES TO TOTAL SALES—BY GEOGRAPHIC DIVISIONS, 1929 AND 1933

Geographic division	Per cent	
	1933	1929
New England.....	29	33
Middle Atlantic.....	25	32
East North Central.....	25	34
West North Central.....	28	33
South Atlantic.....	31	36
East South Central.....	32	37
West South Central.....	31	36
Mountain.....	32	39
Pacific.....	30	39

The retail credit report for 1934 indicated that cash sales decreased to 42.5 per cent of total sales as compared with 43.4 per cent in 1933. Open-credit sales increased to 46.8 from 46.6 per cent. Installment sales increased from 10 to 10.7 per cent.¹

The Department of Commerce² made a detailed study of credit and cash sales of 451 grocery stores in Louisville, Ky., during 1928. Of the stores studied, 35, or 7.8 per cent, sold for cash only; the 416 other stores, or 92.2 per cent, sold on both a cash and a credit basis. The volume of sales of the first group was \$670,242 while the total annual sales of the second group was \$11,108,692. The proportion of credit sales for the cash and credit group was 66.1 per cent.

Table 79 emphasizes the striking increase in credit sales as the size of the store increases.

¹ *Market Research Series No. 3, Retail Credit Survey for 1934, Bureau of Foreign and Domestic Commerce.* This survey includes data for twelve kinds of retail businesses in seventy-nine different cities. Fifty per cent or more of the total sales of furniture stores, household appliance stores, radio stores, lumber and building materials dealers, electrical shops, heating and plumbing shops, coal and wood yards, and ice dealers were made on a credit basis.

² *Trade Information Bull. 627, Department of Commerce, 1929.*

TABLE 78.—PROPORTION OF CREDIT SALES BY SELECTED KINDS OF BUSINESS, 1933¹
Sales are expressed in thousands of dollars

Kind of business	Total number of stores reporting	Total net sales	Credit sales, percentage of total net sales
United States ²	1,526,119	\$25,037,225	
Food group.....	473,916	6,793,010	20
Candy and confectionery stores.....	54,243	271,213	23
Dairy products stores (including milk dealers).....	18,092	498,536	55
Delicatessen stores.....	10,048	170,748	6
Fruit stores and vegetable markets.....	21,897	170,748	15
Grocery stores (without meats).....	163,538	1,803,242	17
Combination stores (with meats).....	140,372	3,201,042	22
Meat markets (including sea foods).....	38,344	491,866	16
Bakeries—caterers.....	19,230	188,181	8
Farmers' supplies and country general stores.....	107,483	1,660,781	35
Country general stores.....	85,839	1,097,437	35
Farmers' supply stores.....	21,644	463,344	36
General merchandise group.....	49,712	3,891,272	26
Department stores.....	3,544	2,544,960	35
Dry goods and general merchandise stores.....	34,122	668,145	16
Variety, 5-and-10, and to-a-dollar stores.....	12,046	678,167	
Apparel group.....	86,548	1,923,333	22
Men's and boys' stores.....	19,491	489,104	20
Family clothing stores.....	5,765	185,371	46
Women's ready-to-wear specialty stores.....	17,759	568,392	28
Furriers—fur shops.....	1,502	41,617	44
Millinery stores.....	9,559	78,060	10
Custom tailors.....	6,986	53,411	37
Shoe stores.....	18,836	424,592	8
Automotive group.....	308,403	4,419,249	33
Motor vehicle dealers (new and used).....	30,646	2,127,720	41
Accessories, tire, and battery dealers.....	16,027	225,970	35
Filling stations.....	170,404	1,531,724	22
Garages and repair shops.....	86,454	519,827	32
Furniture and household group.....	42,976	968,780	66
Furniture stores.....	17,418	553,503	69
Floor-covering, drapery, and upholstery stores.....	2,155	40,462	37
Household-appliance stores.....	9,750	195,531	72
Radio stores.....	8,172	117,030	58
Lumber, building, and hardware group.....	76,098	1,342,705	55
Lumber and building material dealers.....	21,015	603,416	67
Electrical shops (without radios).....	3,257	35,357	60
Heating and plumbing shops.....	11,307	123,128	63
Paint and glass stores.....	7,717	92,318	45
Hardware stores.....	22,844	311,321	36
Hardware and farm implement stores.....	9,958	177,165	46
Restaurant and eating group.....	200,335	1,429,938	2
Restaurants, cafeterias, and lunch rooms.....	124,090	1,089,134	
Other retail stores.....	162,779	2,612,882	
Coal and wood yards—ice dealers.....	23,875	623,077	50
Drugstores.....	58,407	1,066,251	9
Florists.....	7,728	66,493	43
Jewelry stores.....	14,313	175,066	42

¹ Table constructed from Retail Distribution, Vol. V. Ibid.

² Data for second-hand stores and twelve other classifications not shown in detail are included in totals.

Of thirty-four chain department stores reported by the 1933 Census, twenty-two sold on a cash and credit basis. Total sales amounted to \$639,432,000; credit sales equaled \$75,349,000, or 20.74 per cent of the sales of the stores selling on credit, or 11.78 per cent of the total sales of all chains. Credit sales in 1929 were 16.75 per cent of the total sales

of chains selling on credit and almost 10 per cent of total sales of all department store chains.¹

TABLE 79.—CASH AND CREDIT SALES OF LOUISVILLE GROCERY STORES¹

Classification of stores on volume-of-sales basis	Sales less than \$5,000	Sales \$5,000 to \$9,000	Sales \$10,000 to \$24,000	Sales \$25,000 to \$49,000	Sales \$50,000 to \$99,000	Sales of \$100,000 and over
Number of stores.....	42	51	165	111	36	11
Percentage of cash sales.....	49.9	40.5	41.8	34.4	29.7	24.3
Percentage of credit sales.....	50.1	59.5	58.2	65.6	70.3	75.7

¹ *Ibid.*

Factors That Determine Retail Credit Policy.—Whether or not a retailer should conduct a credit business and if so on what basis, depends on a number of factors. The first one is whether he is in a financial position to extend credit to his customers. The second most important determinant is whether the clientele to which he caters wishes to buy on credit. If he is selling to a high-class prosperous group which has been in the habit of buying on credit and which expects and is willing to pay for this service, he should give it. If the community would rather have lower prices than credit and other expensive services, a cash policy would be advisable. There seems to be a decided tendency for the ratio of credit sales to cash sales to increase with the size of the store and the quality of the merchandise sold.

There is a place in practically every city for both credit and cash sales. Many stores have some customers who prefer to pay cash and others who want credit and other services. The equitable policy to follow in such cases is to establish two prices, one for the cash customer, and another—a higher price—for the credit customer. The policy of charging each customer the same price promotes credit sales and discriminates against the customer who does pay cash. The installment credit plan by providing for a carrying charge tends to rectify to some extent this inequality.

Installment Selling.—Installment selling is based upon a form of credit that is paid off or liquidated by installment payments, that is, the payments are made piecemeal or in successive fractions under a plan agreed upon at the time the marketing transaction is consummated. The difference between installment and other forms of credit, according to Professor Seligman, "is to be found in the fact that installment credit is to be liquidated piecemeal or in successive fractions

¹ *Census of American Business, Retail Distribution, 1933, "Variety Store Chains and Department Store Chains,"* p. 9.

instead of in a lump sum."¹ Although this form of credit is based on trust and confidence in the debtor's ability and willingness to pay at the time and in the manner specified, the object sold is also typically utilized as part of the security. The security is usually evidenced by a promissory note secured by a mortgage or trust certificate.

Installment credit has probably been used as long as any other form of credit. The payments of taxes and special assessments on the installment plan have long been in use. This method of financing the marketing of real estate seems to date back to the beginning of the institution of private property in land. It was used in the retail business of Europe long before the American merchant formally adopted the plan. Cowperthwait & Sons, owners of a retail store in New York City, began to sell furniture on the installment plan as early as 1807. Building and loan associations were started in the United States about the same time.² The Singer Sewing Machine Company began using this plan in 1856.³ Somewhat later piano dealers, book publishers, and farm-implement manufacturers began selling on the installment plan.

Today this method of payment is used by consumers in practically all economic classes.⁴ The very poor and the very rich probably make little use of the plan; it is used most intensively by the great middle class. The utilization of the installment method greatly increased after 1921 in the marketing of automobiles, radios, electric washing machines, electric refrigerators, vacuum cleaners, oil burners, gas stoves, jewelry, and tractors and other farm equipment. Its use has now been extended so as to include certain lines of property improvements, such as new bathrooms, sleeping porches, garages, painting, reroofing, and paving alleys. Some capital improvements, such as machinery for factories, bakeries, laundries, and fixtures for retail stores, are being paid for on installments.⁵

When private sources hesitated to finance many kinds of business transactions, the federal government stepped in, furnishing both short- and long-term loans to farmers, home owners, business firms, and others. The Reconstruction Finance Corporation had made loans, subscriptions, and allocations, less repayments, to the amount of \$4,382,854,000 to April 30, 1935. The Home Owners' Loan Corporation closed loans with a cumulative total of \$2,539,408,299 to the first of March, 1935. The federal government, through the Farm Credit Administration, loaned

¹ *The Economics of Installment Selling*, Vol. I.

² IDEN, GILMORE, "Is the Customer Oversold?" *Magazine of Wall Street*, pp. 364 ff., Dec. 28, 1929.

³ *Ibid.*

⁴ 5,000,000 wage earners were involved in installment payments in 1931, according to some estimates.

⁵ *The Business Week*, p. 33, May 22, 1930, quoting M. V. Ayres, analyst of the National Association of Finance Companies.

a total of \$2,379,063,000 to farmers from May 1, 1933, to December 31, 1934. Approximately \$1,500,000,000 was loaned on farm mortgages, that is, long-term loans; almost \$700,000,000 was in the form of short-term production credit loans; and \$194,775,000 was loaned to cooperative purchasing and marketing associations.

Comprehensive figures showing the relative amount of sales of each product on the installment plan, open account, and cash basis are not available. A number of significant estimates, however, have been made.¹ The National Retail Credit Survey disclosed that approximately 75 per cent of stoves and ranges, 58 per cent of all furniture, and 55 per cent of all musical instruments were sold on the installment plan.² Gilmore Iden quotes the following figures: 90 per cent of all household furniture; 80 per cent of all pianos, sewing machines, electric refrigerators, phonographs, and radio equipment; 67 per cent of the vacuum cleaners; and 25 per cent of all jewelry are bought on the installment plan. According to the National Automobile Chamber of Commerce,³ the percentage of automobiles, new and used, sold on installments in 1934 decreased 7.2 per cent compared with those of 1929, but increased 8.2 per cent over 1932. The figures were the same for 1933 and 1934. Table 80 gives the percentages of automobiles sold on installments for the years indicated.

TABLE 80.—INSTALLMENT SALES OF AUTOMOBILES¹

Classification of cars	1928	1929	1930	1931	1932	1933	1934
New cars, percentage.	58.1	62.6	62.3	62.8	54.6	56.8	54.6
Used cars, percentage.	60.8	65.1	64.8	60.4	47.0	56.8	58.1
All cars, percentage...	59.5	64.0	63.8	61.3	48.6	56.8	56.8

¹ *Ibid.*

The relative position of installment sales of automobiles apparently remains quite stable, with the exception noted in the panic year 1932. The annual statement of Montgomery Ward & Company for 1934-1935 listed time-payment and charge accounts to the amount of almost \$20,000,000; almost \$4,000,000 was due on installments on homes sold by the mail-order house. This amount is secured by first mortgage notes and land contracts. The value of reacquired homes held for resale equaled \$6,807,811.57 valued at cost.

Reason for the Development of Installment Selling.—It has been said that installment selling is a development of consumer credit comparable with the development of producers' credit. There is nothing mysterious

¹ Consult *Recent Economic Changes in the United States*, Vol. I, pp. 390-402.

² Credit sales of furniture represented 35.7 per cent of the increase in sales in 1934, while cash sales represented only 14 per cent of the increase.

³ The 1935 edition of *Automobile Facts and Figures*.

about the development of this form of selling. The phenomenal rate of growth of the automobile and radio industries which adopted this method in an aggressive manner after 1921 attracted the attention of the public. The press, associations, and public speakers began discussing its good and bad points and the abuses that accompanied the rapid growth. It required several years to determine the economic and social position of installment selling and to establish organizations and methods for effective control.

Over-production and keen competition among producers are largely responsible for the rapid development. Merchandise and services were coming on the market faster than the consumer could earn money to buy and pay for them. The character of many of the products and the rather substantial sales price made the use of ordinary book credit inadvisable. The installment system, which had proved a satisfactory method for financing the sales of a limited number of commodities throughout a long period of time, was modernized and successfully applied to the new situation.

The installment system of credit permits the consumer to enjoy the use of the product while paying for it. When purchases of many kinds of articles have to be postponed until the buyer has accumulated enough savings to pay cash, he frequently becomes discouraged and ceases to save for the original purpose; the intensity of desire for the commodity is likely to decline with the result that he transfers his interest to some other product or service.

The ease of buying and paying by this method appeals to many consumers. If they have a fairly steady and regular income, payments can be so budgeted that they can be made without inconvenience. When buyers have reached the limit of their income to support further payments, purchases have to be curtailed until enough obligations have been liquidated to provide fresh purchasing power. This situation became prevalent in the early stages of the depression.

Installment Selling and the Business Cycle.—Some merchants and manufacturers learned from experience that the volume of sales of their products was increased through permitting the consumer to pay in installments. The press of competition forced others to adopt the plan. The method probably promotes overbuying, especially during times of prosperity; it may change the flow of the demand toward some products, such, for instance, as the automobile, radio, and electrical refrigerator, and away from others which are not offered on this plan. This situation is more likely to be true in periods of prosperity than during other stages of the business cycle.

The effect of the depression period of the business cycle on the promptness with which installment payments are made is debatable.

When credit stringency appears and the demand for labor begins to decline, the conservative buyer tends to curtail his purchases on the time-payment plan and liquidate his existing indebtedness as rapidly as possible. Some are able to continue their payments out of savings even though they may be temporarily unemployed. If installment sales are unwisely made, as was the practice of some firms in 1929 selling electrical household equipment from house to house, a major business depression will very likely force a large number of repossessions with loss to the selling firms. This situation does not necessarily arise when buyers are conservative, sellers grant credit judiciously, and the possibility of the depression is anticipated.

The Commercial Credit Company reported that on December 31, 1925, almost 0.5 per cent of its outstanding paper was more than 60 days overdue. That percentage rose above 0.8 per cent during the winter and stayed above 0.4 per cent the following winter. Until the middle of 1930, with more paper outstanding, the figure had gone above 0.25 per cent in only two months, and then only slightly—in February and March, 1930—and it had been as low as 0.1 per cent more than once. Repossessions for the first six months of 1930 remained below the figures for previous years. During the first eight months following the stock market panic of November, 1929, automobile sales dropped 30 per cent, yet the drop in dollars of installment financing of automobile sales was only 17 per cent while the financing of the sale of used cars increased. The Federal Reserve Bank of Boston reported more than a normal increase in installment sales of all kinds in its district during the first six months of 1930. A large public utility company reported a 9 per cent increase in appliance sales on installments during the same period. If these data are at all representative, it would appear that installment sales are not materially reduced during the first stage of a major business depression.¹ Retail automobile installments due finance companies in 1933 were only one third of the 1929 peak. As the depression progressed, there was a steady decline in the amount due until the middle of 1933. Trade-ins on sales of new cars increased from 69.4 per cent in 1928 to 72.5 per cent in 1929, to 88.7 per cent in 1932, and then declined to 85.8 per cent in 1933, and to 77.7 per cent in 1934. Total trade-ins in percentage of new cars sold increased from 115.5 per cent in 1928 to 177.5 per cent in 1933, then declined to 159.6 per cent in 1934; the number of used cars sold in percentage of new cars sold increased from 117.0 per cent in 1928 to 185.9 per cent in 1932, and then declined to 171.2 per cent in 1934.²

¹ Few business men and consumers realized at the time that we were in the first stage of a major business depression.

² *Automobile Facts and Figures*, 1935 ed.

Installment selling probably does no more to stimulate ill-advised purchasing and overbuying than many forms of advertising and salesmanship, the offer of "free" deals, quantity discounts, special services, and a number of other constantly used schemes. We are justified in accepting the installment plan as a useful element in our marketing system, but we should not lose sight of the possibilities of abuse and misuse. The character of the results secured from using this method depends upon the judgment exercised by the consumer in obligating himself and the care exercised by the seller in administering the plan.

Factors That Should Be Considered.—There are certain fundamental factors that must be considered if installment selling is to be kept on a sound basis. These factors are conditions concerned with the purchaser, the product sold, and the terms of the contract.

The Purchaser.—Even though the commodity is used as partial security, still the character of the individual purchaser should be carefully considered. The justification for installment purchasing is a need for the product and the ability to pay the installments out of current income. Due consideration should be given to the buyer's other obligations and to the possibility of accident, illness, and involuntary unemployment. Does the purchaser have financial reserves, such as savings account, accident, fire, and life insurance, and sources of income other than his salary or wages? The family or individual who assumes obligations of installment payments to the limit of his income without making adequate provision for the ordinary risks of reduced income places himself in the class of ill-advised speculators. Such individuals are gambling with their future purchasing power.

There are individual buyers who place the burden of determining the limit of their purchases upon the seller. They will, in other words, buy as much on credit as merchants will agree to sell. They follow the policy of "letting the other fellow worry." The effective operation of modern credit bureaus has reduced the damage formerly done by this class of buyers. The one furnishing the credit has to offset the lack of sound judgment and responsibility on the part of the purchaser by carefully investigating his character, moral standing, place of residence, occupation, length of time in present position, number of dependents, recreational interests, outside affiliations, current income, property owned, and other facts that may indicate his *present* and *continued* ability and willingness to meet his obligations according to contract.

Character of the Article.—Economists and business men alike generally agree that the purchase of machinery or other articles that "pay for themselves"—through savings in time, labor, and expense—on the installment plan is justifiable. They agree also that the use of this plan in purchasing merchandise that is consumed before it is com-

pletely paid for is economically unsound. The purchase of commodities that add to the convenience, comfort, education, health, and pleasure of the individual or family, on the time-payment plan, is sound provided due consideration is given to the controlling factors.¹

The product, since it is used as part of the security, must be of such permanent character that if repossession is necessary the seller can dispose of it for an amount equal to approximately the unpaid balance. The sale of food, services, and other goods that are normally consumed immediately after purchase is not adaptable to the installment method. Clothing, generally speaking, falls into this class. Furs, which have a somewhat longer life than ordinary clothing, are sold on the plan. The ten-payment plan used in selling clothing in some sections of the country is another exception. This plan, however, seems to have been substituted in most instances for an open-account system formerly used. The change apparently has improved the credit situation in many instances, since under the open-account plan the average credit period was 60 days or more; under the ten-payment plan, the debt is typically liquidated in 2 months or less. Under this plan a down payment of 25 per cent of the sales price is usually required. The balance is paid in ten weekly installments under a regular, signed customer's agreement. The typical installment retailers, on the other hand, cater to buyers with an income between \$30 and \$40 a week. A first payment of \$5 or \$10 is usually collected on a suit of clothes selling from \$30 to \$40, and the usual terms for the balance are \$2 per week. A 10 per cent discount is usually given for payment of bills within 30 days.² The basis of such credit obviously has to be placed primarily on the customer's ability and willingness to pay rather than on the article sold.

The Terms of the Contract.—The terms of the installment contract should be governed by the nature of the product and the moral and financial standing of the buyer. The amount of the down payment varies for different products and for different buyers. More liberality in terms may be granted to a purchaser whose position and character warrant such treatment. A sound policy demands, however, that the down payment be large enough to give the buyer a substantial equity in the article. He should feel that he owns a product rather than that he is renting it. The standard down payment for automobiles is approximately $33\frac{1}{3}$ per cent, although some sales are made on terms of less than 25 per cent. The percentage of repossessions on new cars with

¹ A. E. Duncan, "The Economics of Installment Buying from the Finance Company's Standpoint," an address delivered before the National Association of Supervisors of State Banks, at Columbus, Ohio, July 20, 1926.

² "The Retailer and the Consumer in New England," *Trade Information Bull.* No. 575, pp. 25 ff.

down payments of $33\frac{1}{2}$ per cent was 2.7 per cent in 1927, and 2.8 per cent for both 1928 and 1929; then it increased to 5.0 per cent in 1932, and declined to 2.6% in 1933. With down payments of 25 per cent the percentage was 5.9 per cent in 1927, 4.1 per cent in 1928, and 5.1 per cent in 1929; it increased to 6.8 per cent in 1932, and then declined to 4.4 per cent in 1933.¹ These figures indicate that the risk is perhaps higher when the down payment is small and general business conditions are unsatisfactory. The down payment on used cars is typically higher than on new cars. It runs, usually, from 35 to 40 per cent. The risks involved in selling used cars on the installment plan are apparently greater than for new cars. The percentage of repossession for used cars with a down payment of 40 per cent was 5.2 per cent for 1927, 5.3 per cent for 1928 and 1929, then increased to 10.4 per cent in 1932, and declined to 7.1 per cent in 1933. With down payments of 35 per cent or less, the rate was 6.9 per cent in 1927, 10.9 per cent in 1928, 9.0 per cent in 1929, increased to 15.0 per cent in 1932, and then declined to 10.0 per cent in 1933. The adverse effects of the depression are clearly indicated by these figures.

The length of the credit period is governed by the nature of the product and the character and financial standing of the buyer. The maximum length of the period should be well within the time in which the buyer will continue to use the article. The probability of the buyer moving away or changing his employment should be given due consideration. The maximum period for automobiles, which have a rapid depreciation, is about twelve months, with payments made in equal monthly installments; for taxicabs the period is only six months; for pianos, jewelry, and articles which depreciate slowly the period is longer and the required down payment smaller.

The risk of loss bears a close relationship to the length of the period. The average direct loss per repossessed car, *i.e.*, the amount owing minus amount received from sale—when there were twelve or less equal monthly payments, was \$43 in 1927, \$56 in 1928, and \$60 in 1929; the amount declined to \$43 in 1931, increased to \$56 in 1932, and declined to \$39 in 1933. In those cases where there were thirteen to eighteen equal payments the loss was \$58 in 1927, \$75 in 1928, and \$83 in 1929; there was a decline to \$66 in 1931, an increase to \$69 in 1932, and then a decline to \$58 in 1933. It is interesting to note the rather substantial increase in the losses during the three years 1928–1930. This was probably due to the demoralized condition of the used-car market during

¹ For the year 1934, approximately 10.7 per cent of new passenger cars were sold on down payments of less than $33\frac{1}{2}$ per cent, and 38.4 per cent of the new commercial cars were sold on this percentage of down payment. *Automobile Facts and Figures*, op. cit.

the time, which made it difficult for the finance companies to dispose of the repossessed cars on a satisfactory basis.

Standard Terms.—The following statement gives the standards with reference to the size of the down payment and the length of the credit period for a number of industries using the installment plan.

Rather oddly, even without agreement to that end, the ridiculously tiny down payment seems to have disappeared. Except at holiday time, when it is still common practice to promise "nothing to pay until after Christmas," dealers have learned the folly of letting goods out to a purchaser who is unable to provide at least a tenth of the price at once. Even this Christmas baiting will be less common in the future.

The new "recommended standard terms" are these:

Kind of product	% down payment	Time in months
Refrigerators, domestic.....	10	24
commercial.....	20	24
apartment house.....	10	36
Washing machines and ironers.....	10	15
Radios.....	10	12
Vacuum cleaners.....	10	12
Stokers, domestic.....	10	24
commercial.....	20	24
Oil burners.....	10	24
Oil burning furnaces.....	10	24
Heating equipment.....	10	24
Furniture and furnishings:		
Unpaid balance \$ 0- 50.....	10	8
51-150.....	10	10
151-200.....	10	12
201-250.....	10	15
Over \$250.....	10	18

Minimum Down Payment and Minimum Monthly Payment, all classes of merchandise, \$4.50.

Observe that these terms do not apply to automobiles or automotive equipment, nor to equipment for stores and factories.

These terms are today, however, "standard" for General Electric, Westinghouse, Kelvinator and General Motors appliances, and for Montgomery Ward & Company. They have also been unanimously approved by such organizations as the National Retail Dry Goods Association, National Electrical Manufacturers' Association, National Retail Hardware Association, and National Retail Credit Association. All these, moreover, have agreed to recommend and urge upon their membership immediate acceptance and promulgation of the "recommended standard terms."¹

¹ HARRING, H. A., "Standards for Installment Buying," *Advertising and Selling*, p. 22, May 23, 1935.

Factors of Security.—The seller extends credit equal to the amount of the unpaid balance. When the financing is done through a finance company, the seller in reality does not extend credit. The buyer usually gives his promissory note for the remainder, secured by a lien in the form of a chattel mortgage on the goods bought, and signs a contract to make regular payments at stated times. When the dealer discounts the buyer's note with a finance company, he usually endorses it, which permits the company to look to the dealer for payment if the consumer fails to meet his obligations.¹ To increase the security the buyer is required to pay for adequate insurance.

The average amount of the notes purchased by finance companies for new cars was \$635 in 1928, \$595 in 1929, \$546 in 1932, and \$516 in 1933, then increased slightly to \$519 in 1934; for used cars the notes averaged \$307 in 1928, \$296 in 1929, \$241 in 1932, \$220 in 1933, and \$216 in 1934. The protection of the seller or the finance company in cases of default depends upon taking prompt action toward repossession. The possibilities of rapid depreciation under the circumstances are so great that total loss of the article may ensue. "Skips" for passenger car purchases per 1,000 transactions were 4.7 in 1928, 5.2 in 1929, 5.5 in 1930 and 1931, and declined to 4.6 in 1933, and 2.1 per cent in 1934. The figure for commercial car purchases in 1934 was 3.3 per cent.²

According to M. V. Ayres, the installment debt outstanding in the United States, at any one time, is never much more than half of the amount created annually and, because of the down payment, is usually only about 40 per cent of the annual installment sales. He estimates that approximately 10 per cent of the outstanding installment paper is held by banks, 35 per cent by merchants, and the remaining 55 per cent by finance companies. He believes that the automobile accounts for slightly more than half of all installment paper. His estimate places the total volume of installment paper for 1929 at approximately \$6,700,000,000, with \$2,900,000,000 outstanding at the end of the year.³

¹ In some instances the endorsement is made *without recourse*. When this is the case the finance company cannot hold the dealer liable if the consumer defaults.

² *Automobile Facts and Figures*, op. cit.

³ *New York Journal of Commerce*, Apr. 21, 1930, in an article which was a reply to one by H. P. Willis criticizing installment selling methods. Dr. Willis took a far less optimistic view, apparently feeling that installment credit comprised a much larger proportion of consumption and commercial credit. He estimated the total amount to be probably in excess of \$10,000,000,000 and that banks were carrying about 25 per cent of this amount. He reasoned that in periods of depression and unemployment there would likely be a large number of people unable to meet their payments; this would lead to "frozen" credit in the hands of the banks and thus to a critical situation in the general field. Dr. Willis and Mr. Ayres obviously are far from agreement.

The following quotation indicates the general procedure followed by the General Motors Acceptance Corporation, which finances the retail installment sales of General Motors.

THE GMAC RETAIL PLAN

Under the GMAC Retail Plan, General Motors dealers may sell the products of the Corporation to customers in good credit standing upon terms properly suited to the purchaser's income. The buyer pays a portion in cash (usually from 30 to 50 per cent, depending upon his circumstances) and gives an obligation for the remainder payable in equal installments adjusted to his income. The price paid is the cash price plus the GMAC financing charge covering the cost of investigation, interest, fire and theft insurance, service, and collection expenses, etc. A lien is retained on the product until payment is completed.

General Motors Acceptance Corporation has recourse to the dealer on all obligations of the purchaser which are bought by the Corporation. Adequate reserves, however, are set up to protect both GMAC and the dealer against loss. Control of credit sales is thus primarily in the hands of the dealer, but his judgment is supplemented by the broad experience of a highly trained credit organization. The deferred payments are made by the purchaser direct to the Acceptance Corporation, relieving the dealer of routine collection details.

The GMAC Retail Plan provides fire and theft insurance in the General Exchange Insurance Corporation, protecting the purchaser and dealer as their interests may appear. A policy is issued to each purchaser so that he may be properly informed of the exact nature of his protection.

Ford sales are financed through the Universal Credit Company; Kelvinator finances the sales of its products through its own Refrigerator Discount Corporation; and General Electric handles its credit sales through the Industrial Acceptance Corporation.

Arguments Pro and Con.—The following summary of argument for and against installment selling is of considerable interest to the student who wishes to survey the question hurriedly from all sides.¹

Arguments in favour of the system:

1. It is preferable to a system of long-term open account, or book credit.
2. It facilitates the enjoyment of amenities not otherwise procurable, and thus promotes efficiency.
3. By making possible the purchase of articles with too high an initial cost to be bought generally for cash, it stimulates demand and increases production.
4. It encourages mass production, and the consequent greater output reduces costs and tends toward an improvement in quality. The resultant fall in prices offsets the increased cost to installment buyers, arising from interest and other charges.
5. Increased production and lower prices raise the standard of living.

¹ Taken from *The Economics of Installment Trading and Hire-purchase*, by W. F. Crick, London.

6. The installment system preserves a balance between production and consumption.

7. It protects principal by encouraging purchases out of income instead of out of capital account.

8. It encourages saving, since some of the money paid in meeting installments on capital goods would otherwise probably be spent on immediate consumption.

9. It promotes hard work, with a view to earning bigger incomes in order to enjoy the amenities made available through the installment system.

10. The necessity of keeping up installment payments encourages systematic budgeting in respect to personal incomes.

Arguments against the system:

1. It promotes extravagance, based on the chances of continuing and growing incomes.

2. It leads to business losses due to inability to investigate and supervise personal credit as thoroughly as business credit.

3. Competition has resulted in the extension of the system to articles which depreciate rapidly.

4. The terms are often too lax, and sometimes there is no difference between the cash and installment prices; thus overbuying is further encouraged and an unfair burden is placed on the cash buyer.

5. Installment paper in banks constitutes a menace in times of stringency.

6. The system presents prospects of increased trouble in times of business depression.

7. It tends to overextension of industry to meet an anticipatory demand, and thus encourages overproduction.

8. It is like monetary inflation, and produces a condition which requires for its maintenance more and larger doses of the stimulant.

9. It encourages the production of luxuries as against non-luxury goods.

10. It creates a body of debt that stands for something already consumed, at least in part.

We come, then, inevitably to a favourable conclusion. At the same time it is necessary to guard against exaggeration, and we have endeavoured to show how the spread of installment buying is not a heaven-sent invention to deliver mankind from poverty and privation, but a useful aid, of quite moderate and limited strength, towards the central objective of economic life, the attainment of a higher and ever higher material standard of living for the great body of men and women, at the cost of a minimum of unpleasant and harmful exertion. We have found the results of installment buying good, though not so amazingly and unqualifiedly good as to warrant the ecstasies with which some observers have greeted it. We cannot for a moment place it on a parity, for example, with the results of the achievements of the last century or so in the technique of industry, transportation, trade, and finance.

Costs of Credit.—Credit costs money. The utilizing of credit tends to raise prices above what would be necessary for the same volume of sales on a cash basis. We have seen that credit is necessary under present

industrial conditions. Modern business could not possibly be conducted entirely on a cash basis; therefore credit must be used. Buyers recognize the economic value of credit, desire the convenience of its use, and are willing to pay a price covering the extra costs. Total costs do not necessarily increase by an amount equal to the costs of credit. When the use of credit makes possible large-scale production and marketing so that unit costs decrease more than the credit costs increase, and other expenditures remain the same, the total costs may conceivably be lower than if credit were not used.

Credit granting involves the performance of a number of expensive activities. The applicant for credit must be investigated as to his character, occupation, resources, liabilities, and reputation for honesty and reliability. Elaborate retail credit and interchange credit bureaus, national in scope, have been organized. Mercantile agencies for investigating the credit standing of manufacturers, wholesalers, and retailers have been in operation for many years. The costs of operating these agencies have to be charged up to credit. Other expenses are encountered in keeping the detailed records necessary for effective credit administration, and for making collections. The individuals and organizations who advance the credit must be paid the market rate of interest for this class of loans. There are additional costs of a somewhat special character, such as losses resulting from bad debts, returns and allowances, and from the process of repossession. The costs of governmental credit are high when the tax rate is considered; 22 cents of each tax dollar goes to pay interest on the national debt of \$28,500,000,000 (beginning of 1935) compared with 2 cents before the war; on June 30, 1935, the national debt was estimated at \$34,250,000,000 with interest charges of \$875,000,000 annually.

Credit Losses.—The ratio of bad debts to total credit sales for 10,264 retail establishments surveyed by the Department of Commerce¹ was 1.2 per cent for installment sales, and 0.6 per cent for charge accounts. Only 0.3 per cent of total retail sales was lost because of bad debts on open-account credit, and 0.2 per cent of total sales was lost on installment sales. The loss percentage on credit sales by grocery stores was 0.7 per cent, and automobile dealers showed a loss of 1.0 per cent on open-account business and only 0.3 per cent on installment sales. The following table² gives the department's figures for the types of stores indicated.

The credit losses in each type of store showed a remarkable decline as the size of store increased, probably indicating a higher type of management. Some sections of the country showed much higher losses than

¹ Cf. "National Retail Credit Survey," *op. cit.*, Part III, p. 64.

² *Ibid.*

others for comparable stores. The percentage of loss was greater for the small firms than for the larger; for example, 719 firms with sales under \$100,000 suffered a loss of 1.535 per cent, while 812 firms with average sales above \$1,000,000 had only 0.352 per cent loss. The total volume of sales of the last group was \$3,038,481,000, while the total volume of the first group was only \$45,310,000.¹

TABLE 81.—RELATION OF BAD DEBTS TO CREDIT SALES

Type of business	Open credit		Installment credit	
	Ratio, bad debts to credit sales	Ratio, bad debts to total sales	Ratio, bad debts to credit sales	Ratio, bad debts to total sales
Department stores.....	0.4	0.1	0.9	0.05
Furniture.....	0.8	0.3	1.4	1.0
Women's, children's, and infants' wear.....	0.5	0.2	3.7	0.9
Men's and boys' clothing.....	1.1	0.4	2.4	0.6
General clothing.....	0.7	0.4	7.9	6.2
Dry goods.....	0.8	0.4	1.4	0.8
Fur goods.....	0.7	0.5	0.8	0.3
Boots and shoes.....	0.8	0.3	No reports	
Jewelry.....	0.5	0.3	4.4	2.5
Miscellaneous.....	0.7	0.4	1.5	0.4

R. G. Dun & Co. reported the following data for 1931: 4,049 firms in more than 150 different divisions of industry with sales of \$4,010,726,000 had credit losses of \$19,489,639, an average of \$4,813 each. The average percentage of bad-debt loss was 0.486 of one per cent; 18 per cent of the firms did 76 per cent of the business, but suffered only 55 per cent of the loss. The percentage of loss of the low-volume group was slightly more than three times that of the highest volume group. The New England group of states showed the lowest percentage loss, 0.435 per cent, and the Southwest group showed the highest loss ratio, 1.230 per cent.²

A large proportion of costs connected with handling returns and allowances should be charged to credit. This is justified on the grounds that credit selling seems to encourage the practice of returning goods by the customer, and the merchant is perhaps more lenient with his

¹ The average bad-debt losses on open-credit accounts and installment credit, as reported by the Department of Commerce Retail Credit Survey in 1934 were about half of the 1933 figures.

² Industrial Credit Loss Survey, based upon 1931 experience of concerns in food, tobacco, drug, and chemical industries. R. G. Dun & Co.

credit customers. The Retail Credit Survey found that for department stores the percentage of returns and allowances on cash sales was 5.9 per cent, on open-account sales, 14.2 per cent, and on installment sales, 13.1 per cent.¹ The 1934 Retail Credit Survey indicated that returns and allowances on total gross sales, including reposessions on installment sales, dropped from 4.7 per cent in 1933 to 4.4 per cent in 1934.

The rate of collection on credit sales is an important factor of cost. In addition to the interest charge resulting from the delayed payments, there are costs connected with sending out notices, statements, collectors, and perhaps court expenses. Installments outstanding were collected at the rate of 13.5 per cent a month, according to the Retail Credit Survey. Buyers were liquidating their indebtedness in slightly more than seven months, when the customary limit was probably 10 to 12 months. Charge accounts were paid off on the average at the rate of 44.1 per cent a month, but some grocers reported collection percentages on open accounts of 66.8 per cent. The average length of time that open accounts receivable were outstanding was 68 days. The 828 reporting stores in 1934 should average monthly collections on ordinary accounts equal to 42 per cent compared with 37 per cent in 1933.

The Rights of the Buyer.—The buyer is entitled to expect, and should receive, the benefit of a fair market price, and ethical and businesslike treatment from the seller. He should be willing to pay a price that covers a reasonable profit and, when he accepts credit, a price that includes the costs of this service. The person who buys on credit should not expect to be able to buy merchandise on a cash-price basis.

The quotation of the total cost to the buyer of goods bought on the installment plan is not always clearly stated by the seller. The following statement, published in *Domestic Commerce*, illustrates this situation.

The cost of credit, as instalment schedules are now drawn, is one of the features most difficult of appraisal. Seemingly credit terms are often made unnecessarily complex with the deliberate aim of confusing or deceiving the customer. Dealer A offers to sell a \$200 refrigerator on the following terms: the list price, less 2 percent, for cash in 5 days; the list price in full for cash in 30 days; or 10 percent down payment, with the balance, plus a carrying charge of 6 per cent a year on that balance, to be liquidated in equal monthly instalments. Dealer B will sell the same refrigerator for a down payment of 20 percent, the balance, plus 8 percent of the list price, to be liquidated in twelve equal monthly instalments, with all carrying charges waived if the account is paid up in full within 90 days. Dealer C, who finances credit sales with his personal capital,

¹ Returns and allowances for 2,048 retail stores in different lines, according to the Retail Credit Survey, during 1927, were distributed as follows: cash sales showed returns of only 5.2 per cent; open-account sales, 9.9 per cent; while returns of installment credit sales amounted to 12 per cent. Returns and allowances were estimated at \$3,000,000,000 annually.

and who refuses to quote instalment terms until he has investigated the customer's credit standing, finally states his terms as \$35 down, and \$10 a month for 18 months. Which of the three plans offers the most favorable rate? Would it be to the advantage of the consumer to pay cash obtained as a loan from an independent agency?

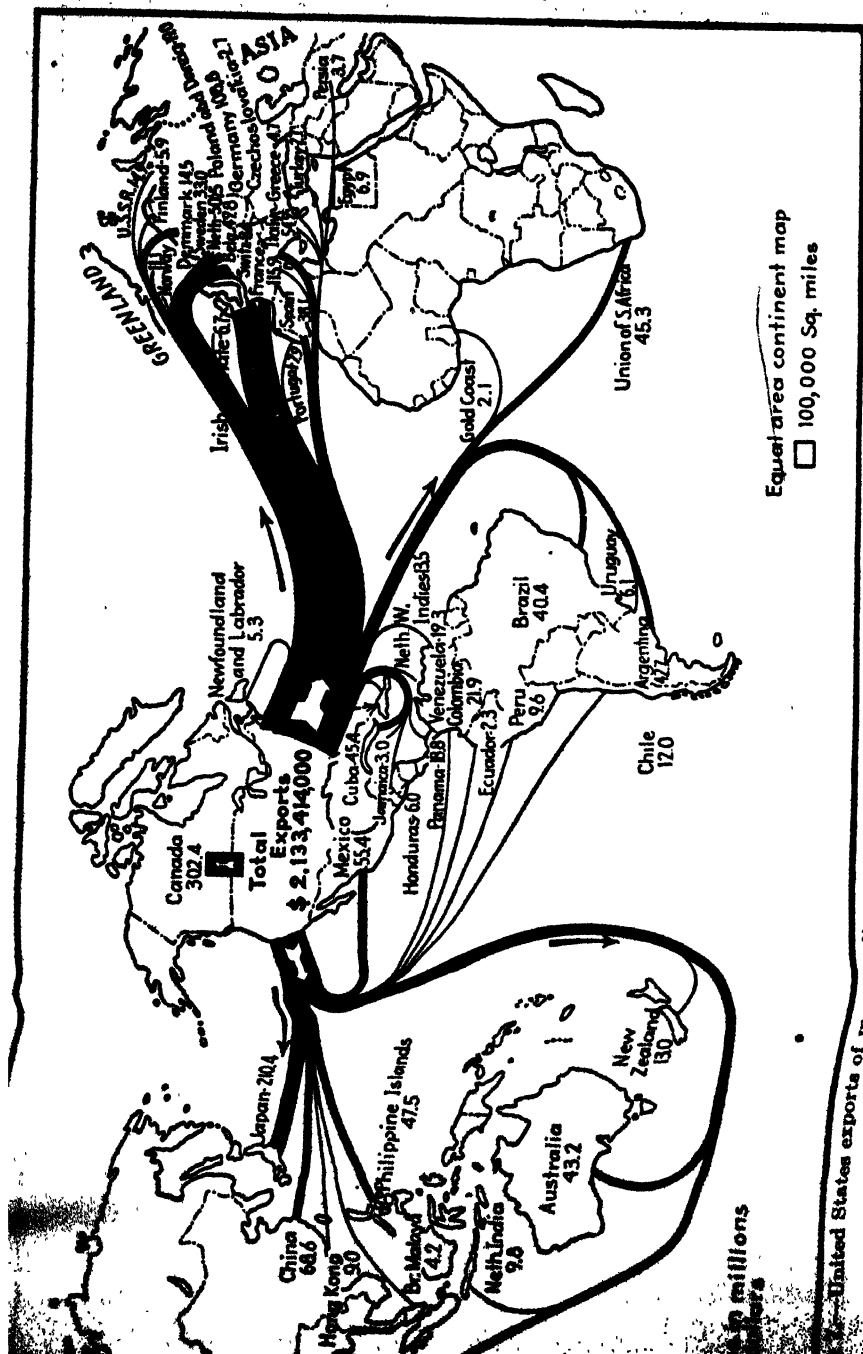
Under existing divergent methods of quoting terms, it is scarcely to be wondered that few instalment purchasers can ascertain what rates for credit are obtainable. The few who exercise their curiosity often conclude, from cursory and unskilful examination, that all instalment credit is extremely costly, or all is quite reasonable. Either generalization may err widely in application to a specific case.¹

Financing Foreign Marketing.—While perhaps less than 8 per cent of our total volume of business in the years 1920–1929 was represented by foreign sales of goods, yet certain industries lean heavily upon foreign trade for their prosperity. Thus normally we export approximately 60 per cent of our cotton crop, 40 per cent of our tobacco production, 40–45 per cent of our lard, 18–20 per cent of our wheat, 36 per cent of our copper output, 31 per cent of our lubricating oil, 40 per cent of the production of typewriters, 29 per cent of the printing machinery, 21 per cent of the locomotives, and 14 per cent of the passenger automobiles.² The drastic decline in our foreign sales during the early 1930's was felt with tremendous consequences by a large number of important industries and those individuals depending upon them for employment and dividends. The effect of this decline upon purchasing power was reflected in a decline of domestic sales, of many other products, to these unfortunate individuals. The decline in foreign sales was the result to some extent of the decline in the purchasing power of foreign buyers. This purchasing power, no doubt, had been somewhat artificially stimulated during the decade following the World War, through the liberal financing policy followed by our exporters and their banks.

According to some estimates, 65,000,000 acres of crop land, or 18.6 per cent of the country's crop area, was required during the period 1921–1929 to produce the agricultural products sold abroad. Approximately 3,000,000 workers were engaged directly and indirectly in producing

¹ From an article by LeBaron R. Foster in the *Journal of Business*, University of Chicago. Quoted in *Domestic Commerce*, May 10, 1935.

² The volume of our merchandise exports declined from more than \$5,000,000,000 in 1929 to approximately \$2,150,000,000 in 1934. The following percentages of our domestic production were exported in 1933: cotton 66 per cent; gums and rosin production 64 per cent; prunes 58 per cent; sardines 51 per cent; tractors and parts 50 per cent; borax 49 per cent; patent side upper leather 47 per cent; power-driven metal-working machinery 41 per cent; office appliances 30 per cent; air craft, engines, and parts 12 per cent; lumber and timber 11 per cent; automobiles 7 per cent. *Memo-randum on Factors Affecting Foreign Trade Policy*, Department of Commerce, 1935.



and transporting goods sold in foreign markets. We, of course, buy goods, for example, rubber, silk, coffee, tea, sugar, bananas, tin and manganese ore, from foreign countries. A country cannot sell to foreign countries over an extended period unless it also buys, or exports "capital or credit." The two maps on the preceding pages indicate in a graphic manner the flow of goods to and from the United States.

During the period 1923-1933 inclusive the United States *sold goods* valued at \$43,265,000,000 to the rest of the world; we, at the same time, *bought goods* from other nations worth \$36,658,000,000. We *sold services* of various kinds, including accumulated interest, valued at \$16,431,000,000; we *bought services* valued at \$8,849,000,000. We *sold securities* and provided other investment opportunities valued at \$5,089,000,000 to foreigners during this period. We *bought securities* from other countries valued at \$9,429,000,000. American tourists *bought services* valued at \$9,849,000,000 in foreign countries. Thus our imports and our exports balance with the sum of \$64,785,000,000 for the period.¹

During the period 1914-1922 the United States changed from a debtor to a creditor nation. At the end of this period the United States was a creditor to the extent of \$16,333,000,000. At the end of the period 1923-1929 the sum had risen to \$18,877,000,000; at the end of the period 1930-1933 the net credit position was \$20,600,000,000. During the period 1923-1929 the United States sent abroad more than \$7,000,000,000; only about \$2,500,000,000 of this, according to Mr. Peek, was used to buy goods, services, and gold from us; the remainder was used to buy stocks and bonds, and to establish short-term credits and bank deposits in the United States.²

The development and maintenance of foreign trade on a large scale, in common with domestic marketing, depend largely upon the ability to finance it. Whether a foreign buyer will purchase his agricultural machinery, grain, cotton, automobiles, electrical equipment, and other articles of merchandise from the United States or some other country frequently depends upon which country will furnish him credit. Much of the large volume of American goods sold to manufacturers and merchants in foreign lands during 1927 and 1928 was made possible through the enormous loans made by Americans to these countries.

Contrasted with Domestic Trade Financing.—The general principles of credit are the same whether used in foreign or domestic trade; the practice, however, is different, due to the character of a number of controlling factors. More time is usually consumed in the movement of goods between seller and buyer when these two are located in different countries. The distances involved and the agencies of transportation

¹ PECK, GEORGE, "Letter to the President on Foreign Trade," June, 1934.

² *Ibid.*

and communication used make the time factor very important. Differences in the forms of money and in banking practices in the various countries complicate the financing procedure. There is need for special forms of security due to the longer time, greater distances, and to the fact that "trust and confidence" are usually not so great when the nationals of one country are dealing with the nationals of another. The risks of loss and damage from fire, water, shipwreck, collision, and other hazards of the sea are ever present. The tariff, health, and other laws of the various countries present more or less serious obstacles in the way of the free movement of trade between nations. All of these factors, together with others, have led to the development of certain terms, practices, and customs unique in the foreign-trade field. The prices quoted by the seller frequently take into consideration all the costs involved, such as interest, discounts, commissions, foreign revenue stamp charges, and other necessary expenditures.

Principal Documents Needed.—Because of the conditions pertaining to foreign trade outlined above, credit administration typically requires certain specific documents. The more important ones are (1) the negotiable bill of lading which is viséd by the consul of the country of destination; three copies of the ocean bill of lading usually are issued by the steamship company; (2) a marine insurance policy or certificate of insurance; (3) a consular invoice; (4) commercial invoices; and, in some instances, a certificate of origin, packing list, and a health certificate.

The principal financial instrument used in foreign trade is the bill of exchange. This may be drawn by the seller on the buyer; when the drawee acknowledges his responsibility under the terms stipulated therein by writing the word "accepted" across the bill, and signs his name, it becomes a trade acceptance. It may then be held by the seller until maturity or discounted by him at some bank or in the acceptance market. When the buyer is not well known or his credit standing is in doubt, the seller may be authorized, through a commercial letter of credit furnished by the buyer, to draw the bill against some designated bank. When this bill has been accepted by the bank, it is known as a banker's acceptance.

The seller takes the draft drawn according to the terms authorized by the letter of credit, together with the shipping documents, to his local bank and discounts it, thus getting his money immediately. This bank sends the documents to the authorizing bank which accepts the draft. It can now be sold in the acceptance market. The bank that bought the draft from the seller now gets its money. The accepting bank holds the documents until the buyer pays. It will be noted that the accepting bank did not give out any money; it merely permitted the use of its

name and assumed a certain amount of risk. For this service it receives a small commission.

Kinds of Bills of Exchange.—Classified on the basis of the time when they are to be paid, there are sight and time bills. A sight bill or draft is one payable at sight or upon presentation to drawee. A time bill becomes payable at some definitely stated future date. These bills may be drawn payable in the currency of the country of the drawer or of the drawee, or in the currency of some third country. The seller who agrees to accept payment in the form of a draft drawn in the currency of some foreign country assumes the risk of loss or gain due to the fluctuations in exchange rates. He never knows how much money in terms of his own country he will receive when he collects. If the draft is drawn in the currency of his own country, he knows definitely how many units of currency he will receive.

Form of Security.—The basis of security is the product being sold; title is usually transferred by possession of an order bill of lading. The reputation of the seller and of the buyer are also important elements in reducing the risk that the drafts may not be paid. When the seller discounts the draft he has drawn on the buyer, he endorses it. He thereby becomes liable for payment in case the drawee refuses to pay. The character of the product may be such that it deteriorates rapidly; if a delay in shipment ensues, it may become practically worthless. If this situation is not covered in the insurance contract, the seller may have to reimburse the bank.

Parties Involved in Foreign-trade Financing.—There are four major parties typically involved in foreign-trade financing when commercial letters of credit are used: the bank that opens the credit by issuing the letter; the paying or accepting bank on which the beneficiary is authorized to draw; the seller or beneficiary who is authorized to draw; and the importer or buyer for whose account it is opened. When opening a credit, it is necessary to state whether credit is revocable or irrevocable, the tenor of the drafts to be drawn, the amount of the credit, how goods are to be consigned and bills of lading drawn, details of documents required and the disposition to be made of them, where and how insurance is to be placed and to whose order it is payable, expiratory date, and for whose account the credit is opened.¹

A Type Case from the Viewpoint of the Exporter.—The following quotation illustrates the procedure followed, the documents, credit instruments, and financial institutions used in a given type of export trade in which "export credit" is involved and the time draft is drawn in terms of the currency of a third country.²

¹ Cf. *Financing Foreign Trade*, pp. 57 ff., published by the Royal Bank of Canada.

² *Op. cit.*, pp. 21 ff.

A publishing company in Buenos Aires desires to buy one thousand tons of Canadian newsprint. We will suppose that the Canadian selling house does not exact a commercial letter of credit or sight terms, but is willing to extend ninety days' credit. It quotes a price of seventy dollars United States currency per ton, whereas, on payment terms of cash against documents, it would have quoted possibly \$68.60 per ton.

The paper is placed on board the "Canadian Miller" at Montreal, and insured under the open policy of the selling company. Three bills of lading are made out to the order of the shipper, and these and the certificate of insurance are endorsed in blank. A certificate of origin in Spanish, together with a full set of negotiable bills of lading, must be certified by the Argentine Consul at Montreal. Three copies of the certificate of origin will have been prepared, two copies of which, however, are kept by the Consul, together with one non-negotiable copy of the bill of lading. The only remaining papers necessary are commercial invoices, which show, in addition to the price and total cost of the shipment, the number of rolls of paper, their weight and measurement, and any distinguishing marks or numbers stencilled on them. While commercial invoices need not be vised by the Consul, it is sometimes advisable to have this done, as when merchandise is subject to an ad valorem duty, the valuation of the goods may be determined by the customs authorities and the commercial invoices disregarded, unless they bear the certification of the Consul at the point of origin.

So far as documents go, all is now in order, and the shipper is able to draw a draft at ninety days' sight on the Buenos Aires firm, covering the invoice value of the paper. In making quotations, the Canadian company had allowed for incidental charges, such as revenue stamps and collection costs, in addition to interest for the time it would be out of its money. The amount collectible on the draft is, therefore, the face amount only.

Since the bill is drawn in United States dollars, one additional clause is necessary, i.e., "Payable at the bank's selling rate on day of payment for sight drafts on New York."

The draft having been drawn and endorsed, and the complete set of bills of lading and other documents having been attached, the Canadian paper company takes them all to its bank. If it is wise, it will have notified the bank of the fact that the shipment is being made, and will have obtained information on the standing of the importer. If the drawer's credit warrants it, and the drawee's standing is good, the bank will discount the draft, sending the first of exchange and a complete set of documents off to Buenos Aires by the steamer carrying the shipment, leaving the second of exchange and other documents to go via New York. The draft, we assume, will be accompanied by instructions to surrender documents on acceptance and not to protest in the event of non-acceptance, but to cable the Canadian bank for instructions.

After the arrival of the goods in Buenos Aires, the drawee's acceptance of the draft is obtained and the shipping documents are handed over. The bank thus loses the security of the merchandise, and will not receive cash for ninety days. It has now, however, the security of the drawee's name on the draft; and it has always its power of recourse against the maker in the event of non-payment.

We will suppose that no unforeseen event occurs, and that ninety days later, the drawee settles his obligation by a cheque drawn in pesos on his local bank, covering the amount of the draft at the exchange rate named by our branch for sight bills on New York. Buenos Aires Branch carries a Dollar Account with our New York Agency; and New York Agency would be instructed by Buenos Aires to debit this account with the amount of the draft we have been discussing. New York Agency in turn would credit the Canadian Branch with the United States funds thus received.

If the bill had been taken by us on a collection basis, we would have obtained instructions as to how the drawer wished the funds to be remitted to him. Although the draft read that payment was to be made at the bank's selling rate for sight bills on New York, it would naturally be possible to purchase a cable with the amount thus received. The amount of this cable would be less than the amount of the sight draft, but the drawer would save interest by receiving his money at an earlier date.

A Type Case from the Viewpoint of the Importer.—The procedure followed in financing an import transaction based on a commercial letter of credit is well illustrated in the following quotation cited by H. G. Moulton.¹

Suppose an importer in New York desires to buy \$10,000 worth of silk from a firm in Hongkong. The American importer is not known to the Chinese exporting house, and it is out of the question for the Chinese exporter to draw a bill of exchange upon the New York importer and secure the funds by discounting the bill at a Hongkong bank. Moreover, since the importer's credit standing is unknown to the Hongkong merchant, the latter cannot well afford to take the chance of shipping the goods on credit and waiting, say, six months for payment. An arrangement is therefore made whereby the credit of the New York house is, in a sense, guaranteed by a financial institution in which the Hongkong exporter may have confidence.

The New York importer goes to his banker and secures a commercial letter of credit. The letter of credit is addressed to the exporter, and it authorizes a bank, say, in London, to accept the six months' sight drafts of the Hongkong exporter of silk up to a certain total sum and under certain prescribed conditions, pertaining to the attaching to the draft of bills of lading, insurance certificates, etc., these terms all being set forth in the letter of credit. The banker in London is of course notified that the letter of credit has been issued. The letter of credit itself is sent to the Hongkong exporter. Not until the receipt of this letter of credit, which (when confirmed by the London bank) assures him that a responsible financial house is willing to accept drafts drawn upon it and specifies the terms on which the goods are to be shipped, does the Chinese exporter proceed with the shipment of the silk.

As soon as the goods have been shipped, the exporter draws a bill of exchange on the London bank, pins to it the bill of lading and the insurance certificate, and then takes the draft to his local bank in Hongkong, where it is discounted. The

¹ *Financial Organization of Society*, 3d ed., pp. 384 ff. Reprinted with permission of the University of Chicago Press.

whole transaction is then closed so far as the exporter is concerned. It may be added that the Hongkong bank will have no hesitation in buying the draft because it can either sell it to Chinese importers who must make remittances to London or sell it to London directly for collection. It may be added, also, that the development of the American acceptance market would not necessarily lead to a general practice of drawing on American banks in this connection, for the reason that American bills would not be in active demand in Hongkong, the financial relations of which are primarily with England, and also because of the lower discount rate that characteristically obtains in the London market.

The goods are meanwhile on the way to New York. The draft, with bill of lading and insurance certificate attached, is now sent by the Hongkong bank to its correspondent bank in London, which presents it to the bank that has agreed to accept it. It is accepted and marked payable at a definite date, say, April 1. When the draft is accepted, the bill of lading and insurance certificate are detached (in case it is a "documents acceptance" as distinguished from a "documents payment" instrument), the accepted bill is returned to the bank that presented it, and the bill of lading and insurance certificate are sent to the New York bank which originally arranged the commercial letter of credit. It may be noted that the accepted draft (bank acceptance) may be sold by the bank which has it in its possession to other banks in London, or to individuals desiring high-grade short-term investments. In fact, such an acceptance often changes hands many times during the interval between the date of acceptance and the date upon which it is due.

By the time the bill of lading and insurance certificate have reached the bank in New York, the consignment of goods may also have arrived there. The New York bank therefore turns the bill of lading and insurance certificate over to the importer of the silk, thus permitting the importer to secure the release of the goods and offer them for sale. It will be noted that unless the individual can secure possession of the goods he cannot sell them, and if he cannot sell them, he cannot well turn over to the bank with which the letter of credit has been arranged the funds necessary to pay the London discounting bank. For it must be remembered that in the last analysis it is the importer who does pay for the goods. Concretely, the process of payment is as follows:

The importing house pays to the New York bank \$10,000 sometime before April 1. The New York bank turns these funds over to the London accepting bank before April 1. On April 1 the London accepting bank pays \$10,000 to whatever individual or bank may present the bill for payment. It will be seen, however, that if the importer fails to put the bank in funds before it has to remit to London, the New York bank will have to advance the funds out of its own resources. And, in turn, if the London bank did not receive funds from its New York correspondent before April 1, it would have to pay the bill out of its resources. Both banks, therefore, assume some risk; and as compensation each receives a commission, the amount varying but being commonly from $\frac{1}{4}$ to $\frac{1}{2}$ of 1 per cent of the amount of the bill for every thirty days that it runs.

Governmental regulation of foreign trade became more pronounced during the depression. Several countries whose chief exports are raw

materials found the demand declining rapidly as the depression progressed. Since they depended on the exchange received for these exports to pay for the manufactured goods imported and to service their foreign debts, they found themselves unable to meet their accustomed financial obligations. Practically all countries resorted to methods designed to promote exports and to limit imports. The result was that the various governments established higher tariffs, import quotas and embargoes, and designated the use that could be made of the limited available exchange. Domestic currencies in several countries were devalued so as to encourage sales to foreign countries. Some countries subsidized, in one form or another, their export industries. These aggressive export policies were usually met with some form of retaliation on the part of the manufacturing countries. The quota, embargo, and higher tariffs were commonly used by these countries. The chaotic condition resulting greatly impeded the international flow of merchandise and services. This brief statement serves to emphasize the importance of the financing function in foreign trade.

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Questions for Discussion

1. "People who twenty years ago would have scorned to purchase anything for which they could not pay, and who looked upon such methods of buying as befitting only the ignorant or improvident, today buy bigger homes, bigger automobiles, and even bigger radio receivers than they have the money for which to pay." How do you account for this changed attitude? What are the economic and social consequences?

2. "A very considerable proportion of working capital is secured, however, through the use of relatively short-time credit." From whom is this credit secured? What are the forms of credit instruments used? Under what disadvantage is a farmer, manufacturer, or merchant who cannot obtain credit.

3. "Certain fundamental elements affect the current funds normally needed in a business." Name and illustrate the more important ones.

4. Explain the financial services rendered by (a) factors, (b) cattle-loan companies, (c) cold-storage companies, (d) finance companies, (e) credit companies, (f) commercial banks, (g) building and loan companies, (h) commercial paper houses.

5. "Whenever a product is sold—whether the seller be manufacturer, wholesaler, or retailer—on other than a cash basis, the seller is engaged in selling not only merchandise, but also credit." What is the significance of this statement? What is credit? Distinguish between "investment," "mercantile," and "consumption" credit.

6. "Every merchandising enterprise calls also for temporary additions to its capital to meet needs arising from a number of circumstances." What are some of the more common circumstances? Do these additions have any relation to market finance?

7. "The great expansion of the use of commercial credit is one of the characteristic developments of the past fifty years which has done much to determine the character of the commercial mechanism." Put meaning into this statement by giving concrete examples.

8. "The problems of seasonal finance are particularly interesting to students of marketing because they are due largely to market conditions." What are the causes?

9. "The time-payment plan is really a form of anticipating normal sales." What are the *immediate* and the *ultimate* effects upon the marketing problem?

10. "Not only does market finance exercise a profound influence upon trade channels but it also exerts pressure on the adoption of certain marketing policies." How does market finance affect the choice of channels of distribution and the establishment of marketing policies?

11. Compare and contrast, briefly, (a) the organizations, (b) the policies, and (c) practices in domestic and foreign trade financing.

12. Why does the financing function assume such importance in foreign trade?

on the downward trend, there is a tendency to reduce production and curtail expansion programs. Under certain conditions, however, a downward trend in prices tends to stimulate increased production. Large overhead costs and lack of mobility in capital, labor, and management may encourage the movement.

The economists who admit the existence of business cycles recognize four distinct periods—depression, improvement, prosperity, and liquidation.¹ It is usually impossible to locate the exact dividing lines between these stages. While each cycle has its own individual characteristics, each period has certain common general characteristic features.

The depression stage of the cycle is characterized by caution on the part of consumers and business men. Sales of durable goods decline greatly; prices of raw materials and many other products fall drastically; unemployment is widespread and wages are reduced; factories are closed or are operating on a reduced schedule, and business failures are numerous; prices, profits, and interest rates are low; and business men hesitate to launch new enterprises. This situation may continue from a few months to several years. The period of improvement comes with increased demand for raw materials—accumulated stocks having been greatly reduced during the depression period—employment increases, the demand for merchandise begins to rise, and a feeling of relief and even optimism appears. The prosperity stage arrives when factories are running full time, unemployment is at a minimum, laborers are working overtime, wages are on the upward trend, prices of some commodities are rising rapidly, and merchants and manufacturers begin to accumulate stocks. Costs tend to rise even more rapidly than prices, profits become uncertain, but there is a general feeling of optimism and a belief that a new era has arrived.

The liquidation stage, which is usually shorter than any of the other three, typically appears suddenly and unexpectedly. There may be a severe financial crisis with a stringent credit situation and high interest rates. If the situation develops very rapidly and is quite severe, a panic may ensue. Many manufacturers overextend their production facilities, burden themselves with fixed interest charges, and accumulate stocks of high-priced raw materials during the period of prosperity. Merchants are likely to fill their shelves and warehouses with large quantities of merchandise. Suddenly sales fall off—this may be referred to as a “buyers’ strike.” The true explanation probably is that debts have inordinately expanded and that the purchasing power of the consumer has failed to advance as rapidly as have prices and production; or it may be that too large a proportion of the national income has gone into fixed capital and investments and not enough into the purchase of

¹ Cf. HARDY, C. O., *Risk and Risk Bearing*, Chap. V.

consumer goods. The result: factories are closed, building activities are curtailed, workers are laid off, money is hard to borrow because of frozen assets and the uncertainty of the general business situation; distress selling of merchandise and securities, runs on banks, hoarding of funds, debt liquidation in the form of foreclosures, and bankruptcies appear. Business men are nervous; they become ultraconservative, and hope for better conditions but fear the worst. After the excitement of the sudden change subsides, the cycle moves along into the depression stage described above. The painful and costly process of adjusting supply to demand and of building up the destroyed purchasing power is started once more.

Each industry apparently has a more or less characteristic cycle of its own; some may be in the prosperity stage when general business is declining or is in the depression period. The electrical goods industry, for example, seems to have three-year cycles. There was a decline in orders received in 1921, 1924, 1927, and 1930. After each year there are, typically, two good years. The drastic depression years of 1931 and 1932 may have changed this tendency; sales reached the lowest point in 1932, and increased during 1933, 1934, and 1935. A given period of prosperity or depression may be world-wide, as for example, the period of prosperity in 1928-1929, and the depression period in 1930-1935, thus reflecting world economic conditions; or it may be confined to one country or to a small group.

Some economists and a number of business men believed, prior to the depression of the thirties, that business cycles were a thing of the past. It was argued that the Federal Reserve System made it possible so to control the supply of credit that prices, production, and purchasing power would be kept in proper balance; consequently, there would be no more maladjustment. Many people believed that our improved technique for assembling, analyzing, and interpreting economic facts provided us with a method for adjusting supply to demand so effectively as to prevent periods of serious over- and under-production. The disillusionment was both sudden and painful. The devastating effect of over-indebtedness and unwise apportionment of the national income on business conditions had not been clearly recognized. Much had been done, it is true, to remedy previous defects in our economic organization. Our financial system had been strengthened and made more flexible; more and more business executives had become *research minded*; and cooperative methods designed to facilitate more effective control over production and marketing had been inaugurated. Only a beginning had been made, however, in establishing a dependable control mechanism. The industries throughout the entire world have become so vitally interdependent that localized attempts at control can have at the best

only an alleviating effect. The best that can be expected under present conditions is that the rise may not be so high and the fall so low as formerly, since a certain amount of periodic rise and fall seems inevitable for many years to come.

A belief developed during the early 1930's that the ups and downs of business conditions could be controlled through a "planned economy," the planning to be done by the federal government. The Supreme Court, in several decisions, has made this impossible until the federal constitution has been so amended as to permit more centralization of economic and political power in the executive branch of the federal government. There are, however, grave doubts as to whether "centralized planning" would prove satisfactory as a risk-control mechanism. The fact is that governmental action of this type creates a new source of risk. Whether more old risks can be eliminated, transferred, or mitigated than new ones are created is a debatable question.

Miscellaneous Sources of Risk.—Risks from a number of sources are encountered by the producers and marketers of services and of agricultural, natural, and manufactured goods. The quantity and quality of crops and live stock may be reduced by diseases. Epidemics among consumers may increase the demand for drugs, and for the services of physicians and hospitals, but reduce the purchasing power of the consuming group for other forms of merchandise and services.

A farmer may see his crop suddenly ruined by insects, drought, storms, frosts, or floods, and his buildings destroyed by cyclones and fire.¹ A large herd of hogs may be wiped out in a week's time by cholera. Such losses not only cripple the productive capacity of the farmer, but they also reduce his power to purchase. Thus the effect of his misfortune is passed along to the manufacturer and the laborer in the city, who supply the farmer with his manufactured goods and buy his agricultural products. The risk of loss to the farmer, in many of these instances, can be transferred to an insurance company upon the payment of a fee called the "premium." The social loss, however, cannot be transferred; society is forced to bear the risk and pay in the form of higher prices.

The effect of weather uncertainties upon grain prices is indicated in the following two news items, one of which was published in July, 1929, and the other in July, 1935.

Blazing into a new conflagration on Monday, the wheat market went whirling upward again at a furious rate, and left \$1.50 a bushel prices far outdone. Specu-

¹ I. L. Ressler estimated, for example, that insects, plant diseases, and weeds cause an annual loss to agriculture of \$6,500,000,000. There are, he states, 6,000 known species of insects that cause an annual loss of \$2,000,000,000. Thirty-four known insects alone cause an estimated damage of \$924,440,000 annually. Reported in the *New York Journal of Commerce*, July 31, 1935.

lative buying took on breakneck speed, and raced values up to 8 cents above Saturday's closing level.

Meanwhile spring crop conditions were reported as fast becoming more and more wretched with an authoritative estimate of yields in the Canadian prairie provinces putting the total at 219,000,000 showing last year's figures reduced already much in excess of one-half.

Wheat closed excited, 7¢ to 7½¢ higher than Saturday's finish, with rye showing 5½¢ to 5¾¢ gain. Corn closed 2¼¢ to 3½¢ up, oats 1½¢ to 2¢ advanced, and provisions unchanged to 5¢ down.

Surprise over sudden advances in price of Liverpool wheat, where setback was expected, did much on Monday to set the wheat trade afire in Chicago. The Liverpool market, besides being affected by news of temperatures above 100 in Canada and by word of persistent absence of any important rainfalls over drought territory either north or south of the Canadian boundary, was also influenced by anxiety as to forthcoming supplies, the amount of wheat on ocean passage being decreased both as compared with last week and a year ago, while inordinately dry weather continued in Argentina and Australia, and port strikes in Argentina were a further menace.

Wild fluctuations at times, however, retarded Monday's giant upward swing of the Chicago wheat market. Nevertheless, each setback proved brief and brought only augmented buying. The day's top figures were reached in the late dealings, and were coincident with indications of big export business going on in domestic winter wheat, with Canadian export prices 10 cents a bushel above the market.

Corn, oats, and rye moved up with wheat. Moreover, Illinois, Indiana, Missouri, and Kansas crop reports told of unusual backward conditions of corn growth.¹

The 1935 news item reports another source of risk, and indicates the effect on world prices.

Renewed apprehension over possible black rust damage to spring wheat in the Dakotas resulted yesterday in a sharp upswing in the Chicago futures market, while disappointingly low grade of hard winter wheat deliveries led to a rise of from 4¾¢ to 7¾¢ in the quotations of that grain at Kansas City.

Other grains followed the leadership of wheat to register good advances, while sugar, cotton, metals and rubber also made substantial price gains yesterday.

Reports of black rust from all over the Dakotas received at Liverpool converted the lower opening there into a near record gain of 2½d., which at the new sterling rate of exchange amounted to 3¾¢ per bushel. Fear of rust and its possible spread northward also stiffened the Winnipeg market, where August wheat rose 1½¢ above the pegged price.²

The bountiful crop years of 1931 and 1932 were followed by the drought years of 1933 and 1934. There was heavy rainfall throughout the United States and a large part of the world during 1935.

¹ News item by the Associated Press, published July 23, 1929.

² *New York Journal of Commerce*, July 10, 1935.

Actions of governmental units constitute major sources of risk, for example, new taxes, new laws and regulations, embargoes, devaluations of currencies, going off the gold standard, silver purchase plans, competition with private industry, special aid to some industries, and restrictions placed on others, and many other acts too numerous to mention and discuss in a book of this type. The following quotation suggests some of the effects of such risks upon business activity.

Prospective demand for goods plus abundant credit resources spell profit opportunities; but an important reason why business has been slow to grasp them is that the ordinary risks were increased by reform activities and experiments undertaken by the government.¹

The Control of Marketing Risks.—A portion of the risk element in marketing may be administered more or less satisfactorily by reducing risk through information; transferring risk through the insurance and certain other forms of contracts; and the hedge. Many risks, however, that arise from mistakes in judgment cannot be transferred, eliminated, or mitigated.

The Use of Information.—Accurate market information tends to reduce risks. Market news, however, that is of any practical value to the producer, the merchant, and the consumer must be reliable, timely, and distributed widely and simultaneously. It must be skillfully and honestly interpreted if it is to serve the best interests of society. Weather reports, private and government crop estimates, shipping embargoes, or the belief that inflation is imminent may cause potential buyers to rush into the market and bid wildly against each other for what appears to be a short supply. Within a brief time conditions may change, with the result that prices fall precipitously. While the sellers under the above-mentioned conditions may have been fortunate and the buyers unfortunate, society has not been benefited by the excitement due to false information.

Scientific method and more reliable information offer a means for reducing some risks. Universities have contributed much in the development of scientific methods for measuring the factors that control demand. The government provides much information that is valuable in reducing market risks. Reports giving estimates of acreage planted or abandoned, condition of the crops, probable yields, stocks on hand, prices, and conditions in other parts of the world are published at intervals. Similar reports concerning live stock are issued. These reports are of value to farmers, packers, millers, merchants, exporters, importers, and many others. Consular reports give information concerning production, demand, competition, and prices in foreign countries. The Survey of

¹ *Brookline Forecaster*, June 12, 1935.

Current Business, published by the U.S. Department of Commerce, presents vital information in the form of weekly business indicators and the trend of business movements. The various census reports give basic information of much potential value.

Boards of trade, commodity exchanges, commercial agencies—such as Dun & Bradstreet; statistical and research companies—such as Standard Statistics, Brookmire, Moody, and Babson; and a large number of trade associations collect much valuable information, classify, analyze, and distribute it together with some interpretation. A number of trade journals are active in discovering and distributing a wide variety of facts, suggestions, and reports of methods and experiments that may be of assistance to their readers and advertisers. Some of these publications give useful information about current business conditions, the outlook for the future, and the probable trend of the demand and supply of the merchandise the subscriber handles.

All of this information is valuable, yet uncertainties remain. Each interested group has to interpret the information and then *decide* what to do about it. These decisions, in themselves, are the sources of many new uncertainties as far as marketing conditions are concerned. If the decisions of each business executive were available to all the others, new and revised decisions based on this new information would have to be formed.

The Contract.—The chance of loss through price changes, failure of supplies, and other similar uncertainties may be transferred and frequently actually reduced through the use of a contract providing for future performance according to specification at a definite price. Assume as an illustration, that a firm wishes to expand its plant facilities. It might buy in advance and store the large quantity of lumber, brick, cement, structural ironwork, and other materials needed. If this were done, the probable effects of inexperience in buying, interest charges, and risk of deterioration would make total costs of construction uncertain. The usual method followed is to contract with various sellers to deliver the materials in certain quantities, at stated times, and at definite prices. The firm by means of these contracts for future delivery transfers to, and spreads the risk among, a large number of contractors. Since these contractors are usually specialists in their lines, the risk of loss is probably considerably less than if the original firm had attempted to assume the full burden of risk-bearing.

Contractors and others who submit bids to furnish finished products usually try to protect themselves by first securing tentative offers or options on the raw materials, ingredients, or parts that enter into the finished goods. Protection against strikes and labor disturbances during the construction period or for a definite period is sometimes secured.

through formal agreement with the unions. Fire, tornado, and fidelity insurance is used to reduce or eliminate the losses from these sources.

The Hedging Contract.—The hedge is a form of speculative contract used extensively on organized commodity exchanges to reduce the probability of loss from undetermined price changes. The hedging transaction, in theory, is simple; in practice it is quite complicated and frequently misunderstood. Hedging has been referred to by some writers as furnishing price insurance. In theory the "perfect hedge" does insure the hedger against loss from price fluctuations; in practice the insurance is usually enjoyed by the financing agency back of the hedger. The situation that produces a perfect hedge for the principal is something of an anomaly. While hedging does not usually insure completely against loss from price fluctuations, it does furnish a means for reducing the probabilities of great loss in a large number of instances.

A hedge is consummated by *simultaneously buying and selling* in the cash and the futures markets; thus a purchase of the actual commodity and a sale of a contract for future delivery, or the purchase of a contract calling for the acceptance of delivery in the future and a sale of the actual commodity, are made simultaneously. The purchase and sale of contracts for future delivery are made on some organized commodity exchange. Table 82 indicates some of the salient features involved in futures trading on the leading commodity exchanges.

There are two forms of hedges, the hedge sale and the hedge purchase. The *hedge sale* is used when, for instance, a cotton merchant *buys* cash cotton and at the same time *sells* a futures contract for an equivalent amount as protection against a fall in price during the time he holds the actual cotton. The *hedge purchase* is used when, for instance, a miller sells flour or cotton goods for cash and *purchases* wheat or cotton futures to protect himself against an advance in the price of the raw materials. A manufacturer may use either form of hedging when the occasion warrants. Thus a rubber manufacturer may use the buying hedge when he contracts to deliver his manufactured product at a given price before he has purchased his raw rubber. He buys futures for the month or months when the raw rubber will be needed. When the time comes to use the rubber in manufacturing, he buys in the cash market and closes out his hedge by selling the futures contract he holds. The price quoted on his manufactured product was based on the price he paid in his purchase of the futures contract. He may use the selling hedge when he has large stock of raw materials on hand and has no forward contracts for the manufactured product.

A cotton or silk manufacturer might use the selling hedge as a protection against overbuying of the commodity in the cash market and the buying hedge as a means of protection if he has not bought enough raw

TABLE 82.—GUIDE TO THE COMMODITY MARKETS¹

What	Where	Unit of trade	Minimum fluctuation	Round turn commission	Margin per contract
Bellies.....	Chicago Board of Trade	30,000 lb.	0.025¢ per lb.	\$12.00	\$ 300
Butter.....	Chicago Mercantile Exchange	300 tubs (18,200 lb.)	¼¢ per lb.	82.50	400
Canned food.....	Commercial Exchange of Philadelphia	1,000 cases (3 doz. each)	¼¢ per doz.	20.00	300
Cheese ²	Chicago Mercantile Exchange	1 carlot (22,000 lb.)	¼¢ per lb.	28.50	250
Cocoa beans.....	New York Cocoa Exchange	30,000 lb.	0.01¢ per lb.	25.00 to 40.00	300
Coffee.....	New York Coffee and Sugar Exchange	30,000 bags (32,300 lb.)	0.01¢ per lb.	25.00 to 40.00	500
Copper.....	Commodity Exchange, New York	30,000 lb.	0.01¢ per lb.	40.00	600
Cotton.....	New York Cotton Exchange	100 bales (50,000 lb.)	0.01¢ per lb.	30.00	500
Cottonseed.....	Memphis Merchants Exchange	50 tons	5¢ per ton	15.00	200
Cottonseed oil.....	New York Produce Exchange	1 sack (60,000 lb.)	0.01¢ per lb.	30.00 to 39.00	600
Cottonseed meal.....	Memphis Merchants Exchange	100 tons	5¢ per ton	30.00	500
Crude oil ³	Commodity Exchange, New York	2,000 barrels of 42 gallons at 60 degrees Fahrenheit	¼¢ per doz.	32.20	300
Eggs.....	Chicago Mercantile Exchange	400 cases (12,000 doz.)	¼¢ per bu.	5.00	10 per cent
Flaxseed.....	Duluth Board of Trade	1,000 bu. 42,000 gal.	0.01¢ per gal.		
Gasoline ³	Commodity Exchange, New York	2% more or less at 60 degrees Fahrenheit			
Grains.....	Chicago Board of Trade	5,000 bu.	¼¢ per bu.	12.50	10 per cent
Hides.....	Commodity Exchange, New York	40,000 lb.	0.01¢ per lb.	30.00 to 40.00	500
Lard.....	Chicago Board of Trade	60,000 lb.	0.025¢ per lb.	30.00	500
Lead.....	Commodity Exchange, New York	60,000 lb.	0.01¢ per lb.	25.00 to 30.00	500
Mill feeds.....	St. Louis Merchants Exchange	100 tons	5¢ per ton	20.00	300
Potatoes.....	Chicago Mercantile Exchange	300 bags (36,000 lb.)	1¢ per cwt.	11.10	200
Rubber.....	New York Produce Exchange	10 tons	0.01¢ per lb.	25.00 to 50.00	500
Silk.....	Commodity Exchange, New York	10 bales (1,300 lb.)	¼¢ per lb.	30.00 to 44.00	500
Silver ⁴	Commodity Exchange, New York	25,000 oz.	0.01¢ per oz.	25.00 to 40.00	1,250
Sugar.....	New York Coffee and Sugar Exchange	50 tons	0.01¢ per lb.	25.00 to 50.00	300
Tallow ⁵	New York Produce Exchange	60,000 lb. one tank car	0.01¢ per lb.		
Tin.....	Commodity Exchange, New York	5 tons	0.05¢ per lb.	25.00 to 36.00	400
Tobacco.....	New York Tobacco Exchange	10,000 lb.	0.05¢ per lb.	20.00	300
Wool.....	Wool Association, New York Cotton Exchange	5,000 lb.	0.1¢ per lb.	30.00	750
Zinc.....	Commodity Exchange, New York	60,000 lb.	0.01¢ per lb.	25.00 to 30.00	300

¹ *Business Week*, p. 16, Sept. 15, 1934.² Trading in these commodities has been started since the publication of the table by the *Business Week* in 1934.³ Trading suspended for time being.

materials to meet his orders for finished goods. It is believed by some that hand-to-mouth purchasing has tended to reduce forward selling of many manufactured products and thus reduced the need for hedging. The export cotton merchant frequently contracts to furnish a certain grade and staple to a foreign buyer. The seller will quote a price based on the price of the future for the month in which the merchant must ship. He protects himself by purchasing futures corresponding to the month of shipment.

Between 75 and 80 per cent of the domestic cotton crop is handled by shippers and exporters, and practically all of the cotton so distributed is merchandised on a hedged basis. A large portion of the remaining 20 to 25 per cent which is distributed through other channels is also hedged. It is estimated that around 90 per cent of the American crop is merchandised in ways in which future contracts are used for price insurance.¹

Banking houses and commission firms that finance merchants, elevator and milling companies frequently require these enterprises to carry hedges as a protection against price declines. Firms that hedge receive better credit ratings and are able to operate on a smaller margin of profit. Competition among dealers and manufacturers who hedge tends to cause them to pass this advantage along to the producers and to the consumers through offering higher prices for raw materials and charging lower prices for the finished product.²

Individual producers of grain and cotton seldom use the hedge because of their small-scale production and the fact that they find it more convenient to sell directly in the cash markets. As the cooperative associations develop, there is a possibility that they will use this method of transferring and reducing risk from price fluctuation. The large-scale producers of wheat, cotton, sugar, rubber, and coffee use the hedge to some extent. The more important users of this method, however, are large commodity merchants, line and terminal elevator companies, wholesale grocers, millers, canners, bakers, and other large-scale operators.

The government has at times assumed such a dominant position in some of the commodity markets—for example, cotton and wheat—that benefits of the normal hedging transaction have been greatly modified.

The Simple Hedge.—The foregoing discussion suggests that the merchant, manufacturer, and sometimes the producer are able to separate the risks inherent in their businesses from those that arise from the fluctuations in the prices of the raw materials and finished products. They are, by this division, able to transfer a large portion of the risks from price changes to the specialists of the commodity exchanges and

¹ GARLAND, A. H., *Specimens of Cotton Hedging*.

² Cf. HARDY, *op. cit.*, p. 224.

they can, therefore, devote more of their attention and energy to the activity in which they are most proficient. The following discussion explains in a general way how the hedging process is carried out, and some of its characteristic features and limitations.

Let us assume that a large flour manufacturer has bought 20,000 bushels of wheat, to grind into flour, at \$1 a bushel. The price of this grain may go either up or down before the miller can produce and sell the flour. Unless he can contract to sell the flour at a price based on the price he paid for the wheat, he runs the risk of considerable loss.¹ He may, however, transfer a large portion of this risk to the grain specialists on the board of trade through hedging. When he buys his cash wheat at \$1 a bushel, he can at the same time sell on the board of trade a contract for future delivery. He would select a month for delivery of his option to correspond with the date of the sale of the flour. If we assume the price of wheat for delivery two months from date of purchase of the cash wheat to be \$1.03, the first half of the hedging transaction would appear as follows:

Cash Transaction	Futures Transaction
Aug. Bought 20,000 bu. wheat at \$1.00	Sold Oct. futures at \$1.03

The difference of 3 cents a bushel theoretically pays for the cost of carrying the wheat during the period. It covers such items as storage, insurance, interest, taxes, and shrinkage.

Assume now that the price of spot wheat falls 10 cents a bushel, i.e., to 90 cents. It might be thought that this would cause the miller much anxiety, as he knows from past experience that the price of flour tends to go up and down with the price of wheat. He will have to mark down the price of his flour to correspond with the decline in cash wheat. If the price of futures declines approximately the same amount, as the miller hoped it would, he has gained on his futures transaction what he lost on his grain and flour deal. The entire transaction which prevented either loss or gain would appear as follows:

Cash Transaction		Futures Transaction	
Aug.	Bought 20,000 bu. wheat at \$1.00.....	Sold Oct. futures for 20,000 bu. at \$1.03.....	\$20,000
Sept.	Sold 20,000 bu. in form of flour based on wheat at 90 cents a bu.....	Bought Oct. futures for 20,000 bu. at 93 cents.....	\$20,600
			18,600
	Loss.....	Profit.....	\$ 2,000

¹ He may, to be sure, enjoy a profit if the price of wheat should rise. The miller is, however, a flour manufacturer and not a grain speculator. He expects to make his profit by performing his specialized service in a superior manner. When he transfers the risks of price changes to the specialized speculator on the exchange, the manufacturer removes much of the hazard overhanging his own operation.

Under the conditions assumed in this simple illustration the miller was able to buy in his hedge at 93 cents a bushel. Thus he delivered grain that cost him 93 cents on a contract for which he received \$1.03. If prices had moved in the opposite direction the net result of the hedging transaction would have been the same. He would have gained on his cash transaction but would have lost an equivalent amount on his futures transaction. When the results are as indicated in this illustration, we are said to have a perfect hedge. It will be noted that the *basis*, i.e., the difference or spread between the cash price and the futures price, remained the same for both parts of the transaction. The gain or loss on the hedge obviously will always exactly balance the loss or gain on the cash transaction if the *basis* is the same when the hedge is closed as when it was placed. Under these conditions an upward or a downward trend in prices is immaterial to the hedger, the manufacturer in this instance.

The Importance of the Basis.—It is a general rule, with numerous exceptions, that the spread between the cash price and futures price should always be exactly equal to the carrying charge. That is, the futures price should be just enough higher than the cash price to carry the commodity to the given date, and the more distant date, for example, February futures, should be above the near month, for example, December futures, by the difference in carrying charges. As long as the two markets are affected only by the same factors and to the same degree and extent the spread remains constant, but as soon as market forces begin to affect them unequally a deviation from the constant relationship appears which destroys the "perfect price insurance." The premium on futures over cash prices cannot exceed the carrying charge by any appreciable amount in a free market. If the prices of futures should exceed this amount, traders and speculators would find it profitable to sell futures and buy cash wheat to hold until delivery date. This selling of futures and buying of cash wheat tend to lower the price of the former and raise the price of the latter, thus erasing the premium on futures. The premium of cash prices over the prices of futures, however, is not held in line so readily.¹ The cash price under certain conditions may literally soar above the price of futures. It should be kept in mind that as the delivery date draws near the two prices tend to come together and on the delivery date they are the same.² Thus the manufacturer who uses the purchase hedge can secure full protection if he can wait until delivery date before buying the raw material and if he can use the grades of the commodity that the seller has the option to deliver. If he buys before

¹ Cf. HARDY, *op. cit.*, p. 236.

² This statement assumes that conditions remain normal, i.e., that no "corner" has been effected by some speculator.

the delivery date, he is subject to all the fluctuations of prices in the cash market.¹

The importance of the fluctuation of the basis or spread between the cash price and the futures price is suggested in the following simplified illustrations. Assume the carrying charge to be 3 cents a bushel from the beginning of the transaction to the December delivery date. Consider first a *selling hedge*, in which the spread at the time of placement is equal to the 3-cent carrying charge but which decreases by the time the transaction is closed to 1 cent. The results are as indicated:

Cash Transaction			Futures Transaction		
Aug.	Bought cash wheat.....	at \$1.04	Sold Oct. futures.....	at \$1.07	
Sept.	Sold cash wheat.....	at \$1.00	Bought Oct. futures.....	at \$1.01	
	Loss.....	\$0.04	Gain.....	\$0.06	

The transaction thus provides a margin of 2 cents on each bushel to pay expenses and for profit.

As a second illustration, consider a selling hedge in which the spread at the time of placement is less than the carrying charge but which increases until it is equal to the charge at the time of closing.

Cash Transaction			Futures Transaction		
Aug.	Bought cash wheat.....	at \$1.04	Sold Oct. futures.....	at \$1.05	
Sept.	Sold cash wheat.....	at 1.00	Bought Oct. futures.....	at 1.02	
	Loss.....	\$0.04	Gain.....	\$0.03	

In this transaction the dealer has a net loss of 1 cent a bushel in addition to the expenses involved in making the hedge. The loss in each instance, without hedging, would have been substantial. The futures price declined more rapidly than the cash price in the first illustration, thus allowing a gain on the futures transaction. In the second example the cash price declined more rapidly and brought a loss too great to be compensated for by the gain on the futures deal.

The third illustration considers a purchase hedge.

Cash Transaction			Futures Transaction		
Aug.	Sold cash wheat for de-		Bought Oct. futures.....	at \$1.13	
	livery.....	at \$1.10			
Sept.	Bought cash wheat.....	at 1.15	Sold Oct. futures.....	at 1.17	
	Loss.....	\$0.05	Gain.....	\$0.04	

It will be noted that the price of the futures advanced less rapidly than the cash price with the result that the gain of 4 cents was not

¹Cf. HARDY and LYON, "The Theory of Hedging," *Journal of Political Economy*, pp. 276-287, Apr., 1923.

sufficient to offset the loss of 5 cents sustained on the cash transaction. The net loss, however, is considerably less than if there had been no hedging.

There are numerous instances in which the cash price advances above the futures price notwithstanding the carrying charge. The more common causes of this situation are: a temporary scarcity of the cash commodity; a present demand in excess of the current supply; tenderable grades may not be suitable for the class of manufacturing demand present, so the prices of desired cash grades are bid up until they may greatly exceed the prices of the tenderable grades in the futures market; prospects of a bumper crop may depress the prices of cotton and wheat futures while the supply of the old crop may be so limited as to cause cash prices to soar.

The following illustration indicates the effect of a narrowing of the basis when the cash price is above the futures price:

Cash Transaction		Futures Transaction	
May	<i>Bought</i> cash wheat..... at \$1.15	<i>Sold</i> Oct. futures..... at \$1.05	
July	<i>Sold</i> cash wheat..... at 1.05	<i>Bought</i> Oct. futures..... at 1.02	
Loss..... \$0.10		Gain..... \$0.03	

The decline in the cash price was so much greater than the decline in the futures market that the hedge did not furnish much protection. If the futures had advanced above the cash price, for example to \$1.08 a bushel, there would have been a loss on the futures transaction of 3 cents a bushel in addition to the loss of 10 cents on the cash deal. If this had been a purchase hedge instead of a selling hedge a large profit on the transaction would have been realized. The merchant, manufacturer, and others who use the hedge are not, however, seeking a profit on the hedging transaction; their aim is to reduce their losses from unforeseen and uncontrollable price fluctuations. These few simplified illustrations suggest how imperfect this form of handling risk is, but it is perhaps the best method yet devised.

Hedgers do not typically make deliveries nor do they take deliveries of the commodity in their futures dealings although they "stand ready" at all times to do so. They buy on grade in the cash market and use the futures market for offsetting purposes. All futures contracts are made and all prices are quoted in terms of one or more tenderable grades.¹

¹ At Chicago three distinctly different types of wheat are deliverable—hard winter, soft winter, and spring. A long in that futures market must be prepared to accept whichever one of the three happens to be cheapest in the cash market. At Kansas City No. 3 hard is deliverable at 5 cents discount. This makes the contract that much more unattractive to the buyer. Sidney Anderson, *New York Journal of Commerce*, Apr. 26, 1930.

Minneapolis is primarily a spring-wheat market; consequently we find No. 1

Other grades may be substituted when actual deliveries are made. Grades superior to the tenderable or basis grades are permitted a premium. Certain inferior grades are tenderable at a discount, i.e., so many points "off" the price of the basis grade. This practice makes it much more difficult for a speculator to secure a "corner on the market" than it was when only the contract grade was tenderable. These variations in grades and their corresponding prices add more complications, however, to the successful handling of the hedging transaction.

The following statement of a practical miller presents the buyer's point of view with reference to the effect of the quality of tenderable grades on the value of a hedge.

If the grade of wheat allowable for delivery on a futures contract to a miller is of a quality which he cannot use or which he can use only in limited quantity, the value of his hedge is diminished. Again, if a miller or grain merchant knows that the grain actually or potentially present in the market which will be delivered upon a future contract, although technically of a grade deliverable on the contract, but actually of a quality which cannot be used in a milling mixture or sold otherwise than at a discount, the value of the hedge is diminished and the price structure adversely affected.

The strongest group in most grain exchanges is the terminal elevator group. It "manufactures" the wheat that is to be delivered on futures contracts, and naturally it desires a liberal contract from a seller's point of view. The result, of course, is a contract which is not desirable from the standpoint of consuming buyers, because either of uncertainty as to quality, or actual knowledge of poor quality to be tendered. Quality to be tendered is variable—a variable as between markets, and within a single market from year to year. Variableness creates uncertainty and uncertainty is incompatible with mathematical perfection.¹

The narrowing of the spread between the cash price and the futures price employed for the hedge is detrimental to the seller of the hedge if the commodity bought in the cash market is of premium grade. It is favorable if the commodity hedged is a discount grade. A widening of the spread has the opposite effect.²

Operators in the Futures Markets.—The futures markets are used by two major groups: those producers, merchants, manufacturers, and others who wish to reduce the risk from price fluctuations; and the speculators, those traders who operate on the exchange to secure profits

northern spring established as the basis grade, No. 1 hard spring wheat commanding a 2 cents per bushel premium, and No. 1 dark northern spring, a 1-cent premium. Discount grades are No. 2 dark northern spring deliverable at a discount of 2 cents per bushel and No. 2 northern spring at a discount of 3 cents. The winter-wheat grades are not deliverable on the spring-wheat contract. Baer and Woodruff, *Commodity Exchanges*, p. 14.

¹ ANDERSON, SIDNEY, vice president, General Mills, Inc., *op. cit.*

² BAER and WOODRUFF, *op. cit.*, p. 106.

rather than to reduce risk. The distinction between the two groups is one of intent rather than practice on the exchange. Both groups stand ready to make deliveries and to accept deliveries, but each does so only to a limited extent. The traders buy and sell contracts constantly, thus assuming the major risks and aiding in establishing and maintaining a broad and continuous market in which the other group can buy and sell futures contracts for hedging purposes. Those traders who expect and want prices to advance are designated as "bulls."¹ They, in reality, represent the interests of the producers—the sellers. The traders who expect and want prices to decline, and use their energies to accomplish this end, are designated as "bears." They represent the interests of the manufacturers and consumers—the buyers.

Speculative Transactions.—There are three major classes of speculative transactions usually in progress on the older and more highly organized commodity exchanges. These operations are carried on by the following groups of operators: professional operators, floor traders, and straddlers. On June 30, 1933, approximately 74 per cent of all traders in the Chicago Pit were speculators, 15 per cent were hedgers, and the rest were pit traders or scalpers, spreaders and traders not classified who were in Europe; 3,174 speculative traders in wheat were long June 30; 24 per cent of this group held not more than 1,000 bushels each, and 73 per cent held not more than 5,000 bushels each. Four traders were long 4,610,000 bushels; six others were short 10,710,000 bushels.

The professional speculators buy and sell futures contracts *without* making corresponding cash transactions. They assume the risks incident to such unprotected deals. They hope to make a profit as a result of accurately anticipating the fluctuations in prices. Theoretically, they collect and study all available information, such as production figures, percentage of the crop that has moved to export points, amount afloat and on the way to primary markets, total visible supply, demand and takings, certificated supplies in licensed warehouses available for delivery on futures contracts, prices in other markets here and abroad, relation of spot to future prices, weather, political, and other conditions that may affect prices, and then come to a decision as to whether present prices for future deliveries are "out of line." When they consider prices too low, they are likely to buy; when they think them too high, they sell. These traders not only help to broaden the market and make it continuous, but they also probably tend to prevent fluctuations in prices from being as wide as they might otherwise be.

¹ These traders may, on certain occasions, sell "short" and thereby tend to depress prices. Their hope is to be able to "buy back" at a lower price, and, consequently, secure a profit on the transaction.

Floor traders or pit scalpers are members of the exchange who trade on the normal minor price fluctuations during the day. They, in contrast to the professional speculators mentioned above, typically close out all trades before the end of the day. A floor trader may buy and sell many times during one day's session. He helps to even out the "ups" and "downs" by selling on a small upturn and buying on a small downturn. By these transactions he helps to maintain a continuous market in which the hedger can always make a sale or purchase of a futures contract.

The straddler is a speculator who trades on the variations in prices between different exchanges. When he thinks one market is too high he sells in that market and buys in one he thinks is low. The activities of this group of traders tend to keep all markets on a parity with each other. The same type of transaction keeps the futures prices for different future delivery dates in line with each other. Thus if the price of December futures advances until they get out of line with the price of February contracts, traders will sell December and buy February futures. Hedgers also follow the practice of switching hedges when an advantage arises. The alertness with which the operators act, however, tends to keep the delivery dates and the various markets in line. These operators are speculators in every sense of the word. If they were not present and willing to assume the risks involved, the merchant, producer, and processor would not be able to consummate their hedging contracts. The professional speculators recognize their problems and understand their position. They consequently assume the risks intelligently.

The following quotation from an impartial and authoritative source shows the service performed by professional speculators in the grain trade.¹

It is clear that there exist no large profits of speculators, as a group, which may be supposed to have been made at the expense of either producer or consumer.

They [the speculators] have protected hedging dealers and millers from losses which would otherwise have fallen on the dealers and millers. And the competition of such dealers and millers has probably held margins of others at a level providing little or no allowance for losses on speculative holding and no room for a charge for risk-taking or to cover any excess cost incident to failure to hedge.

On the importance of hedging grain to avoid the risk of price swings, the institute report says:

Over the forty-one years under review, hedging of all the wheat in the visible supply would have saved owners of the wheat losses from price changes averaging

¹ "Financial Results of Speculative Holdings of Wheat. A Study of Futures Trading in the United States over a 41-year period," by the Food Research Institute of Stanford University. Quoted from *New York Journal of Commerce*, Dec. 4, 1934.

close to 0.6c. per bushel per month on wheat held. In individual years savings in consequence of routine hedging would have been great.

Present Status of the Hedge.—The present status of the hedge as an instrument of risk control is well summarized by Mr. Anderson in the following words:¹

Summing up, this may be said: That however perfect a hedge may be in theory, it is seldom absolutely perfect in practice. Its value has undoubtedly been diminished and its integrity lessened by conditions and eventualities which have happened in the last ten or fifteen years. Among these conditions and eventualities are the introduction of protein as a factor in wheat value; the uncertainty and variableness of grades and qualities deliverable upon futures contracts; the geographical limitations of the location of the grain and the cash market in which it may be bought and sold in relation to the futures market; and the intervention of new agencies, operating and marketing methods and theories, the effect and influence of which are still unforeseeable.

Whether the insurance value of the hedge will be so qualified or minimized as to seriously reduce its value to the miller or grain merchant, or as to eliminate hedging as an insurance against price fluctuation altogether and necessitate an increase in the margin between producer and consumer to cover the increased risk, are questions which only time and experience can determine.

Criticism of Organized Produce Exchanges.—Much criticism has been leveled at our organized exchanges by politicians, and some earnest students of economics and of political science. When prices are low, producers of the commodities traded in on the exchanges sometimes blame the futures market. When prices are high, consumers are likely to condemn this portion of the marketing machinery. Few would claim that the system is perfect; many grave abuses have arisen in the past; people with little knowledge of the function and operation of the organization have lost their savings through ill-advised speculation; the futures markets, no doubt, have been used for gambling. The abuses that have developed in connection with the operation of some of the commodity exchanges justify honest criticism and the demand for a certain amount of government regulation. Some politicians, however, have made accusations which are not borne out by the facts. They would destroy an economic agency of great value because some operators have misused it. The following statement presents an argument against the establishment of drastic government control over futures trading.

There isn't any doubt but that there are a certain amount of restrictions necessary to be placed on our great grain marketing system by the Government.

There isn't any doubt but that there are certain abuses that have crept into the system, injected by selfishness of grasping individuals, and that even certain

¹ From an article published in the *New York Journal of Commerce*, Apr. 26, 1930.

rules and regulations have been broken by these same individuals, but there is a limit to restrictions.

Errors get loud noise and are willingly accepted by the public as the general practice of the trade. The orderly processes of our well developed grain handling system are overlooked, as is usual, in noting the unusual thing that happens.

The grain trade does not guarantee 100 per cent perfection of its personnel, but there has been such a system developed with such restrictions and regulations as to make it a difficult matter for one of its members to go far wrong without being apprehended.

In the orderly marketing of grain there is no better order conceivable than the futures trading system, a plan that is the best designed for orderly marketing that could be conceived of, at least better than any other method that has as yet been developed. Enough supervision has been planned for it. It enables the farmer to have a market, no matter what the immediate consumptive demand may be.

Now, a speculator has been lambasted so generously by theorists and taken up so generally by the uninformed that, it becomes necessary for us to take an inventory of the value of a speculator in our marketing system. Every unreasonable restriction placed on the futures trading on the market drives the investor out of it and for the last several years every time restrictions and unjustifiable tampering with this method of trading have been injected, it has resulted in serious market declines.

Why? Because there is absence of buying power for offerings made. If the farmers want higher prices for grain they will find in the end that it can be accomplished by restricting autocratic domination rather than restricting the freedom of trade.

When the speculators are unshackled from the petty restrictions of theoretical hallucinations, unwarranted taxes and restrained individual initiative, then we will have better markets, and surpluses will either have vanished really or will not be so widely advertised as to hang as a pall over the horizon of better prices.¹

A careful consideration of the facts of the case does not necessarily lead to condemnation of either the organization or the method. Changes in the methods of control and operation of the leading exchanges have reduced the opportunity for abuse.² The marketing of grain, cotton, and many other agricultural products used as raw materials would be seriously hampered if futures trading were abolished before some suitable substitute was found. The following statement indicates the use and value of cotton hedging.

¹ Editor, *Farmers' Elevator Guide*, quoted in *New York Journal of Commerce*, Jan. 15, 1934.

² The leading produce exchanges are now subject to a considerable amount of federal and state supervision; the possibility of "cornering" the supply is practically eliminated by allowing a number of different grades to be delivered in fulfillment of the contract and by giving the seller the option of delivering any time during the month of delivery; the contract is satisfied by the delivery of properly authenticated warehouse receipts.

The narrowing of margins, for example, in the merchandising of cotton and the reduction of losses in cotton manufacturing, through the use of cotton futures for price insurance, result in cotton selling higher and cotton goods selling lower than they would if the merchants and mills had to absorb large losses and hence had to operate on wider margins. The rapid absorption of the cotton crop at harvesting time, through the purchase of cotton on a hedged basis by merchants, and through the buying of futures delivered by investors as well as by the trade, helps to sustain cotton prices during the few months when the planter is selling his annual production, thus giving the planter a full price relative to prices prevailing at other times of the year.¹

An editorial in the *New York Journal of Commerce*, in discussing the new potato and citrus fruits exchanges, observed that proponents of these exchanges believe that

. . . by providing futures markets in these commodities, which allows the price to be arrived at publicly, growers will be benefited. Handlers of these products will be able to hedge against market variations in price and thus reduce greatly their possibility of loss. Closer and more active markets for both will be facilitated by outside public speculation. This, in turn, should result in a reduction in the spread between the wholesale price and the price paid producers, and so contribute to such a reduction in distribution costs as the Administration has urged. Such a reduction in costs should be brought about chiefly through enlightening both producers and trade buyers more fully as to the true state of the markets at any one time.²

While a considerable degree of protection from the risks of loss due to price fluctuations can be secured by producers, merchants, manufacturers, and bankers who deal in commodities that have futures markets under the conditions discussed above, these same business men must assume the burden of risk for that innumerable number of commodities for which there is no futures market. Some of these risks may be reduced or transferred through insurance, better management, group action, contracts, and the services of state and national government agencies. Mergers and integration; hand-to-mouth buying; forward orders and contracts; price guarantees; branding, trade-marking, and advertising; technical and commercial research; business forecasting and planning; government control of the credit machinery; crop, business, weather, and other government reports; the activities of various forms of business associations, such as trade associations, associations of commerce, credit, management, and other similar associations: all of these have done and are doing much to reduce the risks inherent in modern industrial life. New risks, some the result of the methods evolved to reduce other risks, are constantly appearing, due to our rapidly changing

¹ GARSIDE, *op. cit.*

² *New York Journal of Commerce*, Oct. 4, 1934.

economic, social, and political methods and organizations. We shall always have a large variety of risks. The problems of the business man and of society are to devise more effective means for discovering their sources, analyzing their characteristics, and for eliminating as many as possible, and reducing the devastating effects of the remaining ones.

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Questions for Discussion

1. Compile a list of as many risks as you can that affect: (a) supply; (b) demand; (c) the physical qualities of the product; (d) price.
2. Give illustrations showing how uncertainties affect the costs of marketing. Why is an uncertainty a risk, and why is a certainty not a risk?
3. Classify, on the basis of source, the risks enumerated in question 1. Can you think of ways by which each risk may be eliminated, mitigated, or transferred?
4. "Knowledge of facts, then, that can be judged on a price basis is market information." Give concrete illustrations.
5. What are the major sources of market news? How is market news disseminated? What are the essentials of an effective market news service?
6. "Thus it seems unquestionable that our recurring crises arise fundamentally out of a lack of information of the market on the part of large numbers of business men, and commercial crises are relatively modern phenomena." Do you think such risks are becoming of greater or of less importance? Justify your answer.

7. "The value of market news depends, finally, not only on the accuracy and completeness with which it is gathered and the speed with which it is disseminated, but also upon the skill with which it is interpreted." Put meaning into this statement.

8. "At the other end of the distributive system the retailer can seldom shift the risk he bears." Do you agree? What can the retailer do about it?

9. "Among the more important means of minimizing risks arising out of market conditions are (a) government regulation of prices, (b) associations and combinations, (c) producing to order, (d) guaranty against price declines, (e) knowledge of the market, (f) effective management, (g) shifting of risks to others." Show how each of these means tends to lessen market risks.

10. Explain the use of insurance in the administration of the risk element. Give examples.

11. Explain the use of forward orders and contracts for the purpose of risk control.

12. Give a brief description of the organization and operation of an organized commodity exchange.

13. What is meant by the following terms: a hedge? basis? future contract? scalper? straddler? pit trader? selling short? rigging the market? cornering the market?

14. How does hedging benefit the farmer when practiced by the cotton and wheat merchants? Illustrate.

15. Distinguish between a "buying" hedge and a "selling" hedge. Illustrate each.

16. "Whenever the cash price is above the futures, or below the futures by less than a full carrying charge, there is no such thing as a complete hedge for cash grain purchase." Why? Illustrate by concrete examples.

17. "The hedger is not, or ought not to be, interested at all in the market movements of the price of the commodity as such; his attention is to be devoted to the relationship between the price of the contract and the value of the silk he is buying or selling. The speculator, who is not a straddler, is interested in the fluctuations in the contract price, and in nothing else, except in an incidental and indirect way." What is the distinction between a hedger, speculator, straddler, and a gambler? How do you account for the different interests?

18. What is the significance of the use of a "basis grade" and the use of deliverable grades?

19. How does the buyer of a futures contract know that he will get the grade he "contracts for"? How is delivery made?

20. Summarize the arguments against the operation of organized commodity exchanges and future trading.

21. Summarize the arguments in favor of future trading.

22. "Speculation may be justified from both an individual and social point of view." Do you agree? Justify your answer.

23. How do you account for the continual addition of new commodities for future trading? (Crude oil, gasoline, citrus fruits, and cheese were added during 1935.) There were arguments against as well as for the establishment of future trading in these products. Are futures in these products being traded in when you read this?

Assignment

1. Problem 2, p. 124. Busby-Durant Company—Future Contracts in the Grocery Field (Review).

2. Problem 1, p. 313. Chicago Board of Trade—Hedging Grain.

3. Problem 1, p. 321. Heegan Mills—Buying Cotton.

CHAPTER XVIII

SALES-PROMOTIONAL ACTIVITIES

Purpose of this chapter: To survey, briefly, the commonly used implements of sales promotion, and to indicate the social and economic significance of the use of each; and to analyze some of the more important marketing problems met in the organization and administration of the various sales-promotional methods and devices.

Mass distribution, the corollary of mass production, is made possible through the effective use of sales-promotional methods and devices. This activity is well exemplified in the practices of the automotive, tobacco, food, and drug industries. Sales promotion may be thought of, for the purpose of this discussion, as comprising all those activities directly pursued by the seller for the purpose of persuading, encouraging, and otherwise attempting to convince the prospective buyer that it is to his advantage to purchase the goods offered for sale. The most familiar and commonly used forms of sales promotion are personal selling, mail solicitation, advertising, and publicity.

Some retail firms use a convenient and easily accessible location as a means of securing and holding customers. The building and equipment may be so designed, laid out, and constructed as to attract a certain class of clientele. The owners of department stores, large furniture and music stores, theaters, hotels, office and apartment buildings, educational institutions, public utilities, hospitals, and banks frequently invest large sums for the purpose of constructing a type of building that will favorably impress their patrons. The expenditure in excess of strictly utilitarian requirements is in reality a sales-promotion cost. Charge accounts and other forms of credit are offered, deliveries over wide areas are provided, liberal returns and adjustments are allowed, and installation, repair, and other services are furnished with the hope and expectation that new business will develop and repeat sales will be encouraged.

The Value of Sales Promotion.—Prospective buyers, as a class, may be indifferent, busy, and exacting. They cannot always judge independently the best values; they may not know of the service, entertainment, and pleasure that may be derived from the ownership and use of new and improved products. The buyer frequently desires information concerning *where* and *when* certain goods can be purchased, and the terms of sale. Many buyers expect to be persuaded, exhorted, and

encouraged to buy; some, in fact, wait expectantly for the seller to take the initiative. They frequently raise objection to such factors as price, service, and various characteristics of the product for the purpose of securing more detailed information. These conditions, together with the modern competitive situation, make sales-promotion activities not only necessary for the seller, but also desirable for the buyer.

Due to a number of abuses and misuses of the devices of sales promotion, considerable criticism has developed against their use. This criticism has centered largely against advertising and so-called high-pressure salesmanship. Some critics apparently feel that all the initiative should be confined to the buyer, and that the seller should merely announce his wares.

Aggressive sales promotion does influence the flow of consumers' and other buyers' money. It may reduce the amount put in savings banks—if the banks do not adopt equally effective methods—and tend to increase the amount spent on the home and for pleasure-gratifying commodities and services. The firms that offer for sale merchandise and services that best meet the desires of the buyers, and at the same time use the most effective sales-promotion instruments and methods, will probably enjoy the greatest sales volume and profits. The sales of less efficiently operated firms may decrease as the sales of the first group increase, since it is obviously impossible to increase the sales of all economic goods simultaneously unless the purchasing power of the country is in some manner correspondingly expanded. Effective use of sales promotion depends on a thorough knowledge, on the part of the seller, of the buying motives and behavior of prospective customers.

The economic and social value of any given device, method, or program used to promote sales depends upon whether (1) it tends to reduce the costs of marketing; (2) it reduces the costs of production by an amount greater than it increases the cost of selling, so that the unit selling price is less than formerly;¹ (3) it increases the utility of the product or service to the buyer to a greater extent than it increases the purchase price; (4) it produces more effective results, considering the cost, than some other form of promotion; (5) it performs a desired service for the buyer; and (6) it promotes or encourages social well-being. The buyer and the seller, each, expects to better his economic or social position through the marketing transaction. Sales-promotional activities should facilitate the consummation of this objective.

We shall confine our discussion of sales promotion to the following methods and devices: personal salesmanship, advertising and publicity, identifying features, and mail communication.

¹ It is assumed, of course, that such elements as quality, quantity, and service remain on comparable bases.

The Salesman as a Sales-promotion Agency.—The most important sales-promotion agency, judged on the basis of cost and volume of sales consummated, is the salesman. The relative costs of salesmen and advertising, the leading forms of sales promotion, are indicated in Table 83.

It will be noted that the expenditures by specialty and department stores for total direct and general selling, the major portion of which is salaries of salespeople, equals approximately one-fourth of the total expenses, while total publicity expense, which is made up largely of advertising expenditures, equals roughly one-seventh of the total expense, or approximately one-half the expense of salesmen. The figures under the heading, Total direct and general selling, for the other members of the retail group and the wholesalers are the percentages paid for the total payroll. The data for selling as a separate item are not available. The expenditure it will be noted is much smaller for bulk materials, such as lumber and coal, and for the wholesale group than for department stores, and the food, clothing, jewelry, and stationery lines. This is probably due to the character of the product, the buying behavior of the typical customer, the larger unit of sale, and the greater volume of sale for each salesman in the wholesale field, building material, and fuel lines. The advertising expenditure in all these cases, with the exception of the wallpaper wholesalers, is relatively small. The extraordinarily large expenditure for advertising by the wallpaper dealers is due to the high cost of their elaborate catalogues.

Some estimates place the number of retail salespeople at about 2,000,000 and the number of salesmen employed by manufacturers and wholesalers at about 600,000. The total number of retail employees in 1933 was 3,433,652; approximately 2,703,325 worked full time. Information as to how many of these were engaged only in sales work is not available. The total number of people employed full time by wholesalers proper in 1933 was 636,194; manufacturers' sales branches employed almost 231,800. Again we do not know how many were employed as salesmen. Galbraith and Black¹ estimate that, based on the 1930 Census, approximately 4,400,000 people were engaged, directly in selling. These figures do not include "other employees," such as waiters, credit people, delivery men, and other similar workers. If we assume the average salary of the retail group to be \$1,000,² the total amount paid to this group is approximately \$2,000,000,000; or if we assume that the retail salesmen costs equal approximately 9 per cent of net sales, then the costs for 1933 would

¹ *Quarterly Journal of Economics*, op. cit., p. 408.

² The average annual income of all full-time retail employees in 1933 was \$986; in 1929 it was \$1,312. The average income of the selling force is probably somewhat higher.

be 9 per cent of the retail sales of approximately \$25,000,000,000, which is about \$2,250,000,000. If we assume the cost of salesmen employed in the wholesale field to be 5 per cent of sales, then the total cost of sales-

TABLE 83.—RELATION OF SELLING AND ADVERTISING EXPENSE TO TOTAL EXPENSE¹
100 per cent = net sales

Type of institution	Number of reports	Total expenditures	Total direct and general selling ² A	Total publicity expenditures ³ B	Delivery expenditures C	Total A + B + C
Specialty stores with sales of:						
\$1,000,000 to \$2,000,000.....	12	39.0	9.0	6.5	1.05	16.55
\$2,000,000 and more.....	14	37.0	8.6	5.9	1.05	15.55
Department stores* with sales of:						
\$ 500,000 to \$ 750,000....	25	34.0	8.8	4.35	0.8	13.95
\$ 750,000 to \$ 1,000,000....	20	35.0	9.1	4.15	1.05	14.30
\$ 1,000,000 to \$ 2,000,000....	53	35.2	9.05	4.7	1.10	14.85
\$ 2,000,000 to \$ 4,000,000....	47	36.2	9.05	5.1	1.3	15.45
\$ 4,000,000 to \$10,000,000....	48	37.1	9.15	5.6	1.55	16.30
\$10,000,000 to \$20,000,000....	17	37.2	9.4	4.95	1.65	16.00
\$20,000,000 and more.....	7	37.2	9.8	4.65	2.15	16.60
Shoe, 1923.....	499	27.4	14.7	2.2	Information not available	16.9
Tire, 1923.....	83	25.5	12.4	1.5		13.9
Grocery, 1924.....	545	18.0	10.9	0.35		11.25
Jewelry, 1927.....	230	39.6	17.8	3.4		21.2
General stationery, 1928.....	146	33.5	18.8	1.4		20.2
Commercial stationery, 1928....	40	33.6	19.8	1.3		21.1
Commercial stationery and printing, 1928.....	67	33.0	20.8	1.3		21.9
Building materials trade:						
Lumber, 1928.....	138	25.0	2.2	0.65		2.85
Lumber and mason materials, 1928.....	61	22.8	1.3	0.55		1.85
Mason materials, 1928.....	62	22.7	1.9	0.3		2.2
Lumber and coal, 1928.....	21	25.1		0.5		0.5
Mason materials and coal, 1928.....	19	25.1	1.5	0.65		2.15
Wholesale merchants, grocery, 1923.....	501	10.6	2.6	0.15*		2.75
Dry goods, southern, 1923....	71	16.6	5.7	0.28*		5.98
Drug, 1924.....	129	15.8	3.7	0.25*		3.95
Automotive equipment, 1924....	151	23.5	8.2	0.95*		9.15
Paint and varnish, 1926.....	62	23.6	6.2	1.2*		7.4
Plumbing and heating supplies, 1927.....	134	20.8	5.0	0.5*		5.5
Wallpaper, 1927.....	54	38.3	7.7	6.0*		13.7

¹ Data on department and specialty stores are for the year 1934 and are taken from *Bull. 96*, Harvard Bureau of Business Research. Other data taken from "Distribution Costs, a Summary of the Common Figures," developed by the Bureau, published July, 1930.

² This column presents the common figures for the group of stores indicated, as reported by the Harvard Bureau of Business Research.

³ The item *publicity* is made up chiefly of expenditures for advertising.

* Includes advertising and "other selling" expenses. The figure for wallpaper companies includes 5 per cent for sample-book expenses.

men for this group would be 5 per cent of \$32,000,000,000 (the reported volume of wholesale trade for 1933) or \$1,600,000,000. The combined cost of retail and wholesale salesmen would be approximately \$3,850,000,000. This amount would be materially increased if the remuneration paid real estate, security, insurance, and other kinds of salesmen were added.

The effectiveness with which goods and services are marketed depends in large part on the character and ability of the sales force. It is the task of the management to determine the major marketing objectives, and then secure and maintain the type of sales force that will aid most effectively in attaining these objectives.¹ The salesmen may be used alone or they may be assisted by advertising, mail communication, and other forms of selling instruments. The best results can be secured only when the management builds its sales organization in harmony with the nature of the product, the size and character of the territory, the kind and quality of the clientele, and any other factors that may affect or be affected by the character of the salesmen.

Securing the Sales Force.—The scientific method of securing a suitable sales force involves an analysis of the job to be performed (*i.e.*, determine what the salesman is to do) and the selection of the individuals who can do the work or can be trained to do it. The task to be performed by the salesmen in any given position determines whether men or women will be most successful, and whether young or old, technically or non-technically trained people should be employed.² Some salesmen are expected to spend all their time in attempting to secure orders; others may be expected to give service and technical advice, and to create goodwill for the company. The management typically places considerable emphasis on the sales record of the salesman, his dependability, initiative, spirit of cooperation, interest in his work, his cost in relation to his sales, and the percentage or amount of profit on his sales. The customer is likely to give greater consideration to the personality of the salesperson, his appearance, manner, intelligence, knowledge, sincerity, and willingness to give service. The customer's likes or dislikes for a salesperson may be extended to the merchandise or service offered for purchase.

The Task of the Salesperson.—Different firms use their salesmen for various purposes. The same salesman may perform a number of these services, or the management may use different individuals to perform the specialized services. Among the diverse uses made of salesmen are the

¹ The objectives may be stated in terms of one or more of the following: number of physical units to be sold, number of customers or dealers to be secured, and new territory to be developed.

² Lyon classifies salesmen as (a) house salesmen—wholesale and retail, (b) canvassers and agents, (c) field traveling salesmen, (d) service men, goodwill builders, and technical experts, and (e) sales executives. *Salesmen in Marketing Strategy*, p. 10.

following: to locate and interview prospects, to secure orders, to give information, to gather information, to develop or restore an attitude of goodwill, to demonstrate the product, to assist in advertising, to make collections, and to make deliveries.¹

A salesman who thoroughly knows his merchandise, understands people, has a pleasing personality, and exercises tact is in a position to render service that will be greatly appreciated by the purchaser. The successful salesman knows that all buyers cannot be treated alike; each customer should be approached and served in a manner that suits his individual disposition. There are talkative and silent, sophisticated and unsophisticated, bargain hunting and liberal spending, determined and vacillating, rude and pleasant customers. The major task of the salesman is to find out what each customer wants and attempt to supply this want in a manner that is satisfactory to the customer and to the firm. This opportunity for the salesman to adjust his actions to the whims of each customer represents the great advantage of this instrument of sales promotion over other forms. It also suggests the chief limitations, that is, high cost and slowness. A salesman can interview only a relatively small number of prospects in a day, whereas a single advertisement in a newspaper may be read by a million people.

The activity of the salesperson that is most strongly criticized is the so-called practice of high-pressure salesmanship. The managements of some manufacturing and wholesaling firms encourage, and even virtually force, their salesmen to use such strong persuasive methods that merchants become overstocked. This practice denotes a shortsighted policy. When a merchant is overstocked, his future purchases from the wholesaler and from the manufacturer will be less until he has had time to dispose of the surplus.² Overstocking is likely to create ill will against both the salesman and his firm, and it probably encourages the cancellation evil.

Some retail salesmen, especially house-to-house and specialty salesmen, use high-pressure tactics with the consumer. The effect is the purchase of merchandise and services which the consumer does not need, cannot afford, and really does not want, as he discovers when he comes out from under the spell of the overpowering salesman.³ This situation

¹ A large yeast company gives a training course for bakers and furnishes them with recipes; a manufacturer of floor covering teaches the dealer how to lay linoleum. The salesman frequently gives the dealer advice on bookkeeping, store layout, display of merchandise, and how to meet customers, and he may train the dealer's salesmen, and aid in making demonstrations and in distributing samples.

² One of the purposes of overstocking the dealer is to put him in such a position that he cannot buy from a competitor of the high-pressure salesman.

³ This is likely to lead to cancellation of orders and the return of merchandise by the buyer.

obviously tends to develop resentment and loss of confidence on the part of the purchaser.

The buyer, however, frequently has real difficulty in making a decision as to what and when to buy. He may want to buy, but may believe that he is paying too much or not getting the degree of quality desired, or that he might be able to buy a better quality at the same price or the same quality at a lower price at another time or place. He may have doubts about the amount and quality of service given by the particular seller. The following list presents a number of commonly given objections that have to be met by retail salesmen.¹

I can get it cheaper at . . . ; that is more than I want to pay; I want to think it over; it is not just what I want; I won't decide today; I want my husband to see it; I want something better; I am just looking; I haven't enough money with me to get it today; I'll wait until goods are marked down; I'm looking for a friend; I want to look around before buying; I like it and I don't like it, I don't know about buying it.

The salesman performs the greatest service for the buyer when he gives him dependable advice, suggestions, and information concerning prices, service, quality, style, or fashion, and when he aids him in determining what he needs, or what his problem is. The salesman is in an excellent position to help the prospect satisfy this need or solve his problem by showing him how the product or service being considered, or how a buying connection with this particular firm will benefit him. The salesman, under these conditions, has an opportunity to assume a professional attitude.

Effective Use of Salesmen.—The nature of the task to be performed and the character of the agency used furnish many occasions during the performance of the marketing process where and when waste in effort and result may appear. The large expenditures necessary to secure, maintain, and supervise a sales force make it mandatory that the salespeople in many lines of selling be not only carefully selected and trained, but also effectively supervised.

There are a number of conditions that make selling by salesmen expensive. The irregular demand for a large number of products in the retail field causes the volume of sales to fluctuate violently from month to month, week to week, day to day, and even during the hours of the day. This situation makes it necessary to employ part-time salespeople who may not be so efficient as the full-time force. More people are kept on the payroll than are kept busy all the time; this situation increases sales cost. The desire of the management to have enough

¹ *Personnel Research in Department Stores*, p. 22. Published by The Research Bureau of Retail Training, Univ. of Pittsburgh.

salespeople to give customers prompt attention, under the situation outlined above, results in a low salary scale. This lack of adequate financial remuneration limits the retailer's opportunity of choice in selecting salespeople. The typical retail clerk is young and relatively inexperienced. The great majority of them are girls who consider this employment as a temporary affair. Well-paid, mature, and experienced salespeople who regard their work with pride and enthusiasm would doubtless give better satisfaction. There are, however, a large number of products and some types of retail stores that do not require a high-grade salesperson. Standardized products of small value, which are bought repeatedly by consumers do not have to be "sold." Consumers "buy," instead of being "sold," green fruits and vegetables, a large variety of food products, sugar, peanuts, chewing gum, cigarettes, the typical 5-and-10-cent variety store products, and many forms of services. Self-serve stores, vending machines, and advertising are reducing for a number of lines the amount of selling formerly done by retail salespeople.

There is ample evidence of great inefficiency in the use of salesmen outside the retail field. These salesmen consume much time in traveling from one prospect to another and in waiting for an interview. C. H. Lang of the General Electric Company stated, in a talk to the Milwaukee Association of Industrial Advertisers, that only 15 per cent of the typical salesman's time is spent in the presence of the prospect; 40 per cent is consumed in getting to the prospect, 10 per cent is used up in waiting to get to the prospective buyer, and 35 per cent is spent in doing clerical or office work. The proportion of time available for each activity varies with the territory covered. Thus a city salesman spends less time traveling and more time in selling than the country salesman.

The Lowe Brothers Company¹ made a study of the work of a single salesman and discovered that his cost per call was \$18.70; he called upon one agent who bought one dollar's worth of merchandise from the company during the entire year;² a town in which no sales were made had been visited seven times at an expense of \$131; one account was called on fifty-two times at a selling expense greatly in excess of the proceeds made on the account; one agency, the sales to which amounted to \$18.70, was called on once. On the other hand, another agency buying \$1,850 worth of merchandise was called on only once, and another customer buying \$208 worth was not called on at all.

Duplication of sales effort is another source of waste. A survey of 839 retail stores in twenty-eight cities representing thirteen distinct

¹ "Methods of Organizing Salesmen's Time" *Business Leaflet 2*, issued by Policyholders' Service Bureau, Metropolitan Life Insurance Company.

² Results show, on the other hand, that for some goods a sale is seldom made on the first call; 85 per cent of orders given by merchants to new men are given on and after the fifth call.

lines—from automobile to stationery stores—revealed that the group was called upon by 9,643 salesmen of jobbers, 13,431 salesmen of manufacturers, 3,539 missionary salesmen, and 194 survey investigators. The proportion of duplication was estimated to be 54.4 per cent. The remedy suggested was more advertising and less personal selling.¹

Incentives and Accomplishments.—The method of paying salesmen is important from the point of view of this discussion because of its effect upon the results secured. The first step in the determination of a satisfactory payment plan is to determine definitely the task the salesman is expected to perform, and then define the qualifications necessary to accomplish the task. The system of payment should be so designed that it will reward the salesman for accomplishing each phase of his task in proportion to its importance or according to the emphasis placed by the management on the different phases.²

There is an upper and a lower limit to the amount of salary that can be paid in any given case. The upper limit is fixed by the amount the business can afford to pay, i.e., as a percentage of the dollar of actual income; the lower limit is the amount that the salesman must receive so that he can live in the manner the firm expects its sales representatives to live; to keep him happy, loyal, and enthusiastic; and to discourage competitors from hiring him. The ideal amount which will encourage the salesman to put forth his best efforts in a manner most satisfactory to the company and to the buyer should be found between the two limits.

The more commonly used plans are straight salary, straight commission, and various forms of quota, profit sharing, and bonus plans. The salary plan gives the management the greatest degree of control over the salesman, but may not provide a strong stimulus for great effort. The commission plan, on the other hand, may furnish a powerful stimulus but it provides the management with little control over the salesman. Many salesmen on the commission plan regard themselves, virtually, as being in business for themselves. The other plans are largely variations of these two plans, in which attempts are made to secure the advantages of both without the disadvantages; or to furnish the salesman an incentive that will cause him to perform according to the wishes of the management.

Trend in Supervision.—The modern trend in sales management seems to be to set the task for the salesman and instruct him how and

¹ Survey made by the Sherman Corporation, summary published in *Class and Industrial Marketing*, pp. 54 ff., April, 1929.

² LANTHROP, LINCOLN, "How to Find the Best Method for Paying Your Salesmen," *Sales Management*, pp. 499 ff., Dec. 14, 1929. Mr. Lanthrop gives seven major plans with forty-five sub-classes.

when to accomplish it. The task is frequently broken down into its component parts, and the salesman is given specific instructions on just how to do each part. To encourage him to give the proper degree of emphasis to each part, some firms have adopted the "point" system of supervision. A point is an arbitrary unit of measurement. Each element of the sales task is rated as worth so many points. This plan of control provides a flexible system which permits instant adjustment to changing conditions. If the management, for instance, wants the sales force to give more effort to securing new accounts, it can raise the number of points allowed for this work; if it wants more effort given to developing goodwill among old clients, an increase in the number of points allowed for this work will give the required incentive. The salesman is paid on the basis of the number of points he earns in a given unit of time.

Determining the Worth of a Salesman.—The value of a salesman to his firm may be tested in a number of ways. If proper standards of performance have been established and an adequate system of reports and records has been devised, an objective test of the work done can be prepared. Some types of information that indicate the salesman's value are his sales volume, by products and periods; relation of his sales to his quota; amount of his expenses and their relation to his sales, his remuneration, and the profit on his sales; profit and loss on his sales; number of calls and demonstrations made and their relation to the new customers secured, and the number and volume of sales resulting; his record with reference to number and character of complaints, claims, cancellations, and price cutting. Increased sales per salesperson, more of the salesman's time utilized in the presence of the prospect and less in shows, walking the streets, waiting in outer offices, and in doing clerical work; more effective routing, more supervision of the kind that shows how, when, where, and why will do much to reduce the cost of selling by salesmen. The costs of marketing, therefore, may be decreased by increasing the efficiency of the personnel. The responsibility for the attainment of this desirable objective rests squarely on the management of the firm.

Advertising and Publicity in Marketing.—Advertising and publicity are generally regarded as two closely related but distinct forces in the field of sales promotion. Advertising has been referred to as *salesmanship in print*. Its primary objective is to sell or to directly aid in selling merchandise, services, and ideas. Publicity is primarily educational in character.

Its ordinary sphere is to acquaint the public with new discoveries or developments of interest, so as to erect a background of information that can later be made to yield sales through advertising and other promotional activities. In

addition, publicity is of utility in neutralizing or subdividing sales resistance, especially misinformation and prejudice; new customs, vital elements in market cultivation, can thus be introduced by arousing interest in their novel features and then a vogue therefor.

Among the other benefits to the industries that are desirable from publicity is the dissemination of goodwill by the release of interesting and favorable facts about a business and its policies. If a company is conducting scientific research with the aim of improving its products, this fact is of concern to consumers, and it is the special province of publicity to acquaint the public therewith.¹

Advertising ranks second only to the salesman as a device for developing and maintaining sales. This importance is suggested by the amount of the expenditures. The Committee on Recent Economic Changes estimated the expenditures during 1927 at \$1,502,000,000. The Denny Publishing Company, New York, estimated the 1929 expenditures for national magazine advertising at \$203,776,077. The Bureau of Advertising of the American Newspaper Publishers Association estimated the 1929 local and national advertising in newspapers at approximately \$760,000,000. Radio advertising was in excess of \$40,000,000 in the same year. Outdoor advertising to the amount of \$75,000,000, and car-card advertising equal to \$20,000,000 was placed in 1928. Direct-mail advertising during the same year was estimated at \$1,000,000,000. None of these figures includes expenditures for lithographed window display, counter display, and novelties.² If these estimates are approximately correct, the expenditures during 1929 for the various forms of advertising were well in excess of \$2,000,000,000.³ The expenditures for advertising were greatly reduced during 1931 and 1932. The improvement in sales in 1934 and 1935 encouraged larger expenditures. Some of the industries with large advertising expenditures are food products, drugs and toilet goods, automotive, household goods, automotive accessories, parts, and supplies, soaps and cleaners, tobacco products, radio, electrical refrigeration, shoes, paints and varnishes.⁴ The rapidity

¹ HAMGER, WILLIAM A., Mellon Institute of Industrial Research, "Whither Public Relations Work?" Summary published in *Domestic Commerce*, June 10, 1935.

² Consult Frank Presbrey, *History and Development of Advertising*.

³ FALK, A. T., director, Bureau of Research and Education for the Advertising Federation of America, believes the total annual expenditure for advertising was approximately \$2,000,000,000 apportioned as follows: newspaper, \$860,000,000; all periodicals other than newspapers, \$340,000,000; direct mail, \$400,000,000; outdoor, \$100,000,000; radio, \$75,000,000; specialties, \$125,000,000; window displays, \$75,000,000; premiums, programs, directory, and reference media, \$25,000,000. *Bull. Bureau of Research and Education*, 1931, Series 1.

⁴ The automotive industry spent in excess of \$107,000,000; the drug and toilet goods, \$61,000,000; food and food beverages, \$55,000,000; home furnishings, \$31,000,000; building materials and supplies, \$13,600,000; and clothing and dry goods, \$12,000,000 on advertising in newspapers and magazines alone during 1929. *Commerce and Finance*, 18, p. 903, Apr. 30, 1930.

with which appropriations for advertising increased during the period 1921-1930, and certain exaggerated claims made and unscrupulous practices followed, have drawn severe criticism against advertising as a method in general, and against the users and producers in particular. Some of the friends and exponents of advertising have proved themselves its worst enemies by closing their eyes to its defects and trying to justify it under practically any and all conditions.

Kinds of Advertising.—The more commonly used forms of advertising, classified on the basis of the kind of mediums used to convey the message, are magazine, newspaper, billboards, car card, radio, mail, packages, inserts, and dealer helps. The national advertising dollar for 1933 was distributed among the leading mediums as follows: newspapers, 48.6 cents; magazines, 31.5 cents; chain broadcasting stations, 10.7 cents; outdoor advertising mediums, 8.0 cents; and car cards, 1.2 cents. According to estimates of the American Newspaper Publishers' Association there were 1,895 daily newspapers published in the United States in 1934; approximately 100,000,000 pennies are spent daily for newspapers; the total daily circulation of newspapers is 38,500,000; 93 per cent of the homes are contacted. Fifteen leading magazines have a total numerical circulation of almost 30,000,000, and reach about 14,753,550 homes. Between 55 and 65 per cent of the homes have radios. These three mediums alone furnish the mass producer an unexcelled opportunity for mass selling.

Each medium has certain advantages which make its use desirable under appropriate conditions. It is an important administrative function of the management to determine what mediums should be used at a given time, and to what extent and in what combination they should be employed so as to produce the most satisfactory results.

The following outline summarizes, by citing a specific instance, the various forms of advertising that may be used profitably by a retail store.

HOW STORES ADVERTISE¹

Newspaper advertising.

- a. Daily newspapers.
- b. Weekly newspapers.

Direct-mail advertising.

- a. Letters.
- b. Postal cards.
- c. Circulars, booklets, leaflets, etc.

Radio advertising.

- a. Spot broadcasts from local radio stations.

Outdoor advertising.

- a. Billboards.
- b. Illuminated store signs.
- c. Signs on delivery trucks.

¹ *Better Retailing*, National Cash Register Company, 1935.

Street-car advertising.

- a. Street-car cards.
- b. Bus cards.
- c. Suburban train cards.

Motion picture theater advertising.

- a. Colored slides.
- b. Commercial trailers.

Advertising by personal distribution.¹

- a. Handbills and dodgers.
- b. Shopping news.

Classified advertising.

- a. In newspapers.
- b. In telephone directories.
- c. In buyers' directories.

Advertising confined to store itself.

- a. Window displays.
- b. Counter displays.
- c. Elevator bulletins.

Advertising is an instrument designed primarily to aid in accomplishing sales on a mass basis. This method of selling, in fact, is likely to prove disastrously uneconomical when used on a small scale in a restricted market. A large, successful, and widely experienced manufacturer is reported to have invented a certain machine to be used in burning the oil out of a filtering machine used in refining oil. An advertising campaign was started to aid in selling the new product. When the campaign proved a failure, an investigation was made to determine the reason.¹ This survey is reported to have revealed only five firms that could use the product. This was a case in which the use of space advertising was decidedly uneconomical.

The Development of Advertising.—Advertising as we know it, according to Mr. Presbrey,² is new in its methods, but its ideas and its objectives are as old as the human race. The first advertisements were announcements of reward for the return of runaway slaves and bond servants, with a description of the runaways. The Egyptians employed a crier to announce the arrival of ships bearing cargoes of wine, spices, and metals. He created interest by describing in florid language the regions from which the goods came and the difficulties under which they were secured. Signboards have been used from ancient times to inform the public as to where certain goods and services might be purchased. With the development of printing came the printed pamphlet, then the newspaper and periodical. The utilization of a number of recent developments in technical processes, such as offset printing, rotogravure, the aquatone process, and the Smithsonian process for the application of

¹ It is no doubt obvious to the reader that the survey should have been made before the advertising campaign was started.

² *Op. cit.*

four-color plates on non-coated paper, have done much to improve the appearance and quality of advertising, thus encouraging wider use. The development of wireless and the radio introduced the radio announcer. The broadcasting station (plus the radio receiving set) became an important advertising medium after 1926. This type of advertising was least adversely affected during the depression. The public is now awaiting the next step in the development of television.

Why Is Advertising Used?—Present-day advertising policies and practices have been bitterly criticized. The use of advertising is not compulsory. Why is it used? The justification for the use of advertising in any given instance depends upon the objectives set and the results secured. Advertising on the highest plane "is not a mere badgering of consumers and a stirring of nascent desires. It takes on the nature of enlightenment concerning value and use." It performs a useful marketing service. It arouses buyers' interest; makes efforts of salesmen more fruitful; saves time of buyer and seller; reaches thousands and even millions at much less cost than is possible by any other means; reduces costs of selling, and may aid in reducing the costs of production. Advertising should have as its objective the *giving of information* in a form that will be seen, read, understood, and appreciated by those to whom it is directed.

Advertising is typically used to sell or help to sell a product, service, or idea. A relatively small amount of advertising is used to make a sale, unassisted by salesmen and other sales-promotional devices. Yet some very effective so-called mail-order advertising is used to sell books, insurance, low-grade securities, and certain articles of merchandise. When and where this is true, there is usually found a well-known standardized product; a sponsoring firm that is well known and highly respected; a product so low in price, or with claims so glowing, that a certain percentage of people are willing "to take a chance." The greater proportion of advertising is used to accomplish one or more of the following objectives: to introduce to the public or trade a new product or firm; to prepare the way for a more cordial reception of a salesman; to induce consumers to ask for, or accept when offered, the advertised product at a retail store, to write for a booklet, sample, or some other form of information; to secure a mailing or prospect list; and to cultivate goodwill and build prestige.

Space and radio advertising and mail communication may be used to reach prospects who cannot be reached economically by salesmen; these mediums are often able to enter where a salesman would encounter great opposition, *e.g.*, in the home, office, factory, and places of amusement. Advertising may be used to carry a message promptly and rapidly to large numbers of people scattered throughout wide areas.

It is a powerful force for expanding industry; it is of little use, for example, to build a large factory in order to secure the economies of large-scale production unless buyers of the product can be found and persuaded to buy. Advertising, however, will not maintain repeat sales for an inferior product; it will not create a fashion, although it may be used to announce and spread a fashion. A well advertised product of satisfactory quality will usually enjoy a larger sale than an unadvertised product of equal quality.

If the advertising program is successful, one or more of the following will be accomplished: the volume of sales will be increased or will not decrease to the extent which otherwise would have happened; costs of selling will be reduced, profits increased, or losses reduced; and, perhaps, the price to the buyer ultimately reduced due to economies of large-scale production made possible by increased sales.

Factors That Condition Success.—The results secured depend upon the character of the advertising itself, the methods used, and the conditions under which the marketing campaign is carried on. There are two sets of conditions. One set comprises such factors as the character of the internal organization and operation of the particular business enterprise, for example, the policies of the firm, the caliber of the management, the financial resources of the organization, and the attention paid to planning, execution, and testing of the marketing program in general, and the advertising phase in particular. The other set of conditions is determined by external factors, such as the general economic, political, and social conditions, and the competitive situation.

The achievement of any particular advertising effort, usually, cannot be separated from the combined results secured from the general policies and methods of operation of the firm. The success of any business activity, which is reflected in increased sales, lower costs of selling, production, or financing, and increased profits or lower prices, is usually the result of a complicated series of business judgments, efficient operation, and fortuitous circumstances.

If advertising is to be used successfully, as is equally true in the use of other selling forces, it must be based upon a careful study of the marketing implications of the characteristic features of the product, and the general and specific conditions under which the marketing activity is to be carried on. A plan can then be formulated which exemplifies and synchronizes with the general policies of the firm and provides for a consistent and intelligent use of suitable forms of advertising. Advertising ability, however, reflects the frailties of the human mind; it cannot be conveniently and reliably graded, standardized, or sold by sample.

Advertising and the Costs of Goods.—The use of advertising may tend to lower prices, or it may actually make it possible to charge a higher

price for the product. When advertising, as was stated before, increases sales so that production can be increased to such an extent as to bring about the economies of large-scale production, prices may be lowered. This will happen when the decrease in the costs of production is greater than the increase in the costs of selling.

Advertising may reduce the costs of selling by establishing consumer and dealer acceptance, thus reducing the costs of personal selling by a greater amount than the advertising costs. Fewer retail and wholesale salesmen are required to secure the same or a larger volume of sales because the salesman spends less time with each customer. Consumers may even serve themselves in self-service stores, by vending machines, and by asking for merchandise by brand name, so all the clerk has to do is to wrap the article and collect the price. Orders may come in by telephone, telegraph, and mail. In an analysis of 45,000 sales transactions the U.S. Department of Commerce found it required twice as long to sell a little-known item, even though it was being presented as an equivalent product, as it did to sell the advertised item which had already been adequately presented to the consumer by the manufacturer.

Even though prices are reduced because of advertising, the buyer, of course, pays for the advertising in all instances where the business is making a profit or breaking even, since the expenditure comes out of the price paid by him. The price paid, however, under the conditions mentioned would likely be higher if advertising were not used.

The influence of advertising on marketing costs and on the prices paid by the buyer is interestingly discussed by Roy S. Durstine in the following quotation.

Suppose you have a piece of information which you want to send to a friend in San Francisco. That costs you 3 cents. Now suppose you want to send the same information to 10 friends. That costs you 30 cents. Increase that number of people to a thousand. Now you are paying 30 dollars just for stamps. But suppose you feel that it is a piece of information which would interest 120,240 people in San Francisco regularly receiving a certain San Francisco newspaper. And then suppose you found that you could send this information to all of them for not \$3612.60 (which would have been the cost of the stamps alone) but for \$627.20 . . . wouldn't that seem a pretty sensible idea? And when you have found that there are so many San Franciscos and Denvers and Kansas Citys, you decide to send your information to everybody in the country and put that information in a magazine which goes to two million women. If you mailed it, just the stamps would cost \$60,000. But the magazine would print your information for you—yes, on the back cover in colors to show just how your package looks on a shelf—for \$13,500.¹

¹ "Roy Durstine, of BBDO, Illustrates the Economy of National Advertising," from an address delivered at the meeting of the U.S. Chamber of Commerce, May 1, 1935.

In an article published in *Printers' Ink Weekly*, Mr. Durstine gives the following information:

A large food company with a very large appropriation spends 3 cents per capita per year and sells a fine product at an extremely nominal price.

Another large food company has cut its marketing cost practically in two through converting some of its selling expense to advertising. Whereas total selling and advertising was 21 per cent at the beginning (16 per cent sales—5 per cent advertising), it is now 12 per cent total (5 per cent sales and 7 per cent advertising).

Bread is now so good and so cheap that hardly anyone can afford to bake it in home ovens. The advertising to make it known costs less than the wrapper to keep it clean.

The story of Sunkist oranges is too well known to need repetition. But the low cost of the advertising which has been an indispensable aid in making orange-growing into a well-ordered industry for the producers and in changing this fruit from a holiday luxury into a healthful daily item in millions of homes is significant. At the maximum the cost of this advertising to the housewife per dozen oranges has been one-third of a cent or one-thirty-sixth of a cent per orange.

The Loose-Wiles Biscuit Company says that on a 10-cent package, the advertising expenditure is less than a tenth of a cent. An executive of a representative packer of vegetables and fruits gives one-tenth of a cent per can as the advertising expense. He believes that this is a fairly standard figure for the canned goods industry.

As you drink a 5-cent glass of Coca-Cola perhaps it will help to refresh you to know that only 1,576/100,000ths of one of your five pennies went into telling the people of the United States about this product. On a Lord Pepperell shirt 64/100ths of a cent has gone into public information about it. A well-known cake of soap carries an advertising cost of one-fifth of a cent.¹

Retail Advertising Costs.—A recent compilation of advertising figures gives the following percentages of gross sales as customary and proper advertising expenditures for the indicated retail stores:²

	Per Cent		Per Cent
Department stores.....	1.5	Furniture.....	6.3
Grocery stores.....	1.0	Drug stores.....	1.0
Haberdashers.....	3.3	Shoe stores.....	2.9
Women's wear.....	3.1	Hardware.....	1.0
General stores.....	1.5	Jewelry.....	3.1
Electrical shops.....	2.7	Florists.....	5.0
Cleaning and dyeing.....	3.3	Millinery.....	2.2
Meat markets.....	1.0	Music.....	3.3
Specialty shops.....	3.8	Restaurants.....	3.1

¹ DURSTINE, ROY S., "Why Advertising Really Is an Economic Tool," *Printers' Ink Weekly*, pp. 7 f., Nov. 29, 1934.

² These figures were compiled by the Business Research Bureau of Northwestern University in cooperation with Harvard. Quoted by Babson.

When quantity production has been established by advertising, it is usually necessary to continue advertising in order to maintain the volume of sales. If the manufacturer discontinues advertising, sales will likely decline, production costs will rise, and prices, eventually, will have to be raised.

Advertising and Prices.—Advertising may make it possible to raise the price or sell at the market-plus by causing the buyer to hold the product in higher esteem than formerly, or than another product of equal value but less well known. A higher price for an advertised product may be justified when the advertising serves as a guarantee of quality, uniformity, performance, and correct style; or when it makes purchasing more convenient and saves time. By aiding in rapidly introducing new and improved products and services over wide areas, the happiness and welfare of large groups of people may be greatly increased through the use of advertising.

Dr. L. D. H. Weld classifies the principal effects of advertising, in so far as it tends to raise prices, as follows:¹

1. On the commodity itself (a) as a guarantee of quality, (b) in making procurement easier, and (c) in packaging.
2. On the manufacturer as a reward for risks assumed.
3. On the buying public (a) from the educational standpoint, (b) in fitting production to the different classes of demand, and (c) in creating new wants and adding to general satisfaction.
4. On general economic progress.

In developing these four points, Dr. Weld says:

Sometimes people are induced through advertising to purchase things they can't afford. This is not so likely to happen from advertising, however, as it is from personal salesmanship.

Wastes in Advertising.—Of course, there is waste in advertising. There is waste in the use of coal to create heat; there is waste in the use of the steam engine to develop power from coal and water; there is waste in the utilization of gasoline in the internal combustion engine; there is waste throughout our everyday living. Should we abolish all the above because of the waste? No one would be so foolish as to advocate this procedure. All would agree that earnest attempts should be made to improve the instruments and methods. The same attitude, it would appear, might profitably be taken toward the use of advertising.

Because reckless drivers of automobiles kill hundreds of men, women, and children annually, do we propose to discontinue the use of automobiles? We attempt to regulate the operation of the vehicles, and to

¹ "When Advertising Raises Prices," a reprint from an article in *The Nation's Business*, April, 1929.

SALES-PROMOTIONAL ACTIVITIES

punish offenders. Could not the same procedure be followed with reference to advertising?

The Pseudoscientific Advertisements.—Advertising has been used by unscrupulous individuals to develop sales for inferior and injurious products by making claims of qualities that did not exist. Pseudoscientific appeals, especially in the field of food products, cosmetics, tooth pastes, toilet soaps, and medicaments have been particularly objectionable. The findings of scientists may furnish excellent copy material when rightfully and truthfully used, but when half-truths and exaggerations are used under the name of science to develop sales through, for example, an appeal to fear, the best interests of advertising are injured. Apparently, federal legislation is the only remedy for this objectionable type of sales promotion.

The Testimonial Copy.—The testimonial and endorsement forms of copy have been greatly overworked. One issue, for example, of a well-known weekly magazine contained ten advertisements that featured a certain movie actress by announcing her as a user or endorser of the products being advertised. A wide variety of articles was included, from wrist watches and wedding rings to chewing gum and cigarette lighters. This form of appeal soon fails to impress the public and thus becomes ineffective and wasteful. Testimonials, on the other hand, that are truthful and sincere may be of considerable value to the prospective purchaser. When large sums of money are paid to famous individuals for the use of their pictures and for their endorsement of some product, the public tends to lose confidence not only in this particular advertisement but also in all testimonial advertisements.

Advertising, irrespective of its quality, cannot force people to buy. It cannot persuade, induce, or deceive them into purchasing, repeatedly, inferior or unsatisfactory merchandise and services. Goods are not bought merely because an advertisement is artistic, interesting, or entertaining. The "truth in advertising" movement, better business bureaus,¹ and the alertness of publishers and radio broadcasting companies have done much to raise the standards of advertising in general. The various

¹ Today the better business bureaus are expected to:

Promote accuracy in advertising, through the cooperation of advertisers, themselves; advertising media; and properly constituted authorities.

Aid in the elimination of unfair competition through promulgation of ethical standards.

Provide an unbiased medium for the settlement of disputes between competitors, and between business concerns and their customers.

Expose fake promotions, and aid in the prosecution of fake promoters.

Warn the public against the endless easy money schemes which divert hard-earned dollars from the channels of legitimate investment and trade.

Furnish dependable, disinterested information on offerings of securities, business

leading advertising mediums reject each year millions of dollars' worth of fraudulent and otherwise objectionable advertisements that are submitted for publication.

The Effective Use of Advertising.—The consumer, as well as the merchant and manufacturer, is interested in the proper use of advertising because of the effect on costs and prices. The relative position of advertising in the marketing program should be determined on a scientific basis. What different kinds of advertising will be used and the relative position of each should be just as carefully determined.¹ There are a number of factors of a technical nature, which, if not properly handled, will lead to waste. The limitations of advertising, as well as its strong features, should be recognized and appropriate action taken.

The Time Element.—Advertising used in an attempt to sell something for which there is a declining demand is wasteful. Any producer trying to persuade women in the United States to wear cotton hose and high-top shoes during 1935 would have been wasting his time and money. The advertising of straw hats in December to the consumer in Chicago would hardly prove successful. Advertising will be most effective when it is *timely*, when it calls the attention of the prospective purchaser to the good qualities of the products near the time when he will want to use them. Merchandise and services bought and used continually throughout the year should be advertised constantly, and seasonal goods in season.²

The Place Element.—Goods should be announced where the prospect can see the statement. If he lives in the country, the message should reach him there; if he lives in the city, that is where the message will be seen most frequently and have the best effect. The radio furnishes an excellent medium for reaching the prospect in his home; the magazine and newspaper also perform this service in a highly satisfactory manner. Poster panels, car cards, window and counter displays, and signs present the message to him when he is away from home.

Excellent advertising copy may be wasted because it is not placed in the proper medium. An advertiser does not buy merely white space and circulation when he places his advertisement in a given medium.

opportunities, or service—thus not only protecting the public, but also removing unjustified suspicion from legitimate enterprise—From a booklet published by the National Association of Better Business Bureaus, Inc., published in *Milwaukee Commerce*, the official bulletin of the Milwaukee Association of Commerce.

¹ Some advertisers maintain that it is the function of printed advertising, salesmen, and direct mail to educate, inform, stimulate, describe, and persuade, while radio advertising should be used to create goodwill through entertainment and to popularize a trade name. "Viewed from this angle radio supplements but does not supplant other forms of sales promotion."

² The successful advertising and selling of furs in August and of coal during the summer is due chiefly to the better values offered in the pre-season sales.

He buys an *opportunity* to reach a given market, to tell his story to a selected and known group. He should carefully consider the character, quality, size, and other important elements of the circulation of the medium. A large number of subscribers may be of no value if they do not constitute a group that may be interested in the product or service being advertised. Advertising placed in metropolitan newspapers and urban magazines, for instance, will not be read by many farmers. This group of buyers may be reached effectively by means of the radio, poster panels placed in suitable locations, farm periodicals, and rural newspapers. The effectiveness of these mediums is probably somewhat reduced during the summer months when the farmer spends long hours in the field.

The standards and policies of the publisher are other factors that should be investigated. The character of these qualities can then be checked against the publisher's advertising rates. Any rate, however low, is an expensive rate if the medium does not present an adequate opportunity to reach the desired market.

Technical Aspects of the Copy.—Much depends upon the technical aspects of the copy. The message must be seen, attract attention, arouse enough interest to secure a reading, and win confidence through the sincerity expressed and the explicit method of statement. It should express good taste, tie up with previous advertisements, and prepare for those to follow. The skillful use of color, illustrations, layout, type, position, and size of space aid in securing attention, maintaining interest, and in getting a favorable reading.

The type of appeal employed usually determines the nature of the response secured. If it is based on the idea of giving help or useful information—showing how the prospect can save or earn money, attain more happiness, beauty, or success, reduce costs, or make a profit—it will probably arouse interest and secure the desired form of action at a reasonable cost.¹

The appeals used by one company in advertising electric ranges were: coolness, cleanliness, convenience, healthfulness, safety, better results, and the release of time to the benefit of the housewife. A gas company wished to increase the number of its customers and to increase the per family consumption of its product. The company demonstrated how gas could be used to cook meals, heat water, warm the house, and refrigerate the food. The method commonly used to increase the consumption of gas is to sell gas-using appliances—ranges, water heaters, home-heating units, as "hardware gadgets, nuts, bolts, and enamel finish. A new method was developed in terms of *human comforts*—better-cooked

¹ A detailed discussion of the technical features of the instruments of sales promotion is not within the scope of this book. Consult textbooks on advertising copy and layout.

foods, cooler kitchens, less slavery to meals, luxurious hot water, carefree house heat, and thrifty refrigeration."¹

Why Some Advertising Efforts Fail.—Some of the reasons why advertising campaigns may fail to produce the results expected are given in the following summary. The student should be able to expand each statement and perhaps be able to give an example for each instance.

1. Failure to instruct salesmen to follow up advertising at point of sale.
2. Failure to inform clerks on sales points of new product.
3. Failure to sell salesmen on value and need for distributor sales helps.
4. Failure of salesmen to promote use of local advertising helps.
5. Failure to instruct salesmen in purpose and sales use of advertising.
6. Failure to train clerks to render prompt attention and courteous service.
7. Failure to plan standard sales story for each salesman.
8. Failure to coordinate advertising and selling.
9. Failure to tie up advertising with local display.
10. Failure to live up to advertising—if you promise a booklet, give it.
11. Inquiries should be followed up personally—not by telephone.
12. Failure to follow up inquiry promptly.

Testing the Effectiveness of Advertising.—The degree of effectiveness attained in the use of any given form of advertising, except the mail-order type, is particularly difficult to measure. The number of different factors, other than advertising, that affect the volume of sales and the amount of profit is so great that it is difficult to isolate the effect of the advertising force and measure its contribution to the whole. The number of variable elements in the advertising itself makes it difficult to identify any particular weak or strong element. A list of some of these elements will serve to illustrate the degree of complexity involved. A change in any one of the following elements of the advertisement may affect to a considerable extent the effectiveness of any given advertisement: size and shape of space; location on the page, or in the magazine or paper; number and arrangement of units in the layout; medium used; time; text; trade-mark; coupon; illustration; color; border; size of type; and the arrangement of type.

The coupon and various systems of keying individual advertisements and mediums frequently give helpful intimations as to the effectiveness of a particular piece of copy or the value of a given medium. The ratio of the number of inquiries or of returned coupons per \$100 spent in advertising can be established for each medium. Similar ratios for the volume of sales resulting may be worked out. Psychological tests of copy performed by presenting a number of different advertisements to a group of students or prospects and getting their reactions, have been used with some success. One of the most satisfactory methods is the test campaign. A few selected advertisements are run in a limited

¹ From an advertisement by N. W. Ayer & Son, in *Printers' Ink Weekly*.

number of mediums in such a manner as to show which particular advertisement seems to get the greatest response. This method, however, has its limitation. A company advertising continually; on a national scale, would probably find it extremely inconvenient to test all its copy in this manner. Again, much advertising copy is of such nature that little positive response can be expected.¹ A firm, in addition to spending money, for sales promotion, should make a liberal appropriation for research activity to test the effectiveness of its advertising, to improve its product, and to reduce costs of marketing and production.

Identifying Features.—The practice of identification may facilitate and make for more effective advertising and salesmanship. Various methods of identifying the sales place and the product have been developed. A large number of chain stores, independent merchants, banks, theaters, hotels, and manufacturers use distinctive external features of their sales places to give them personality and to distinguish them from their neighbors. Brands and trade-marks are attached to a large variety of products so that the prospective purchaser, when buying, can identify the article.

Identifying the Sales Place.²—The features most commonly used to aid the purchaser in locating and identifying the sales place are (1) a definite name for the store, business, or the firm;³ (2) the style of architecture of the building; (3) the nature of the store front, i.e., the shape, color, the nature of the windows and entrances; and (4) signs of various kinds.

The more important reasons for using identifying features in connection with the sales place are (1) to indicate or suggest the ownership of the store; if the name is that of a well-known individual, a favorably known manufacturer, or a successful chain, it is likely to exert considerable influence on initial sales, e.g., a Montgomery Ward retail store, a new Woolworth store; (2) to indicate or suggest the kind of store or merchandise offered for sale, e.g., Rexall Drugstore, or the XYZ Radio Shop; (3) to indicate or suggest the location of the sales place,

¹ For a discussion of some interesting methods of testing advertising copy, consult Daniel Starch, *Principles of Advertising*, John Caples, *Tested Advertising Methods*, and L. E. Firth, *Testing Advertisements*.

² For a rather extended discussion of "Identifying Features of the Retail Sales Place," see an article under this title by the author in *The University Journal of Business*, Vol. II, No. 4; Vol. III, No. 1, September, December, 1924.

³ Names may be used to (1) denote ownership or origin, (2) indicate the nature of the business, (3) designate the location of the store, (4) suggest a major policy of the firm—reliability and dependability of the merchandise, service, or firm; economy, high quality, and exclusiveness. A large number of coined and fantastic names, whose chief function seems to be to attract attention, arouse curiosity, and, perhaps, aid the memory, e.g., Piggly Wiggly, Dew Drop Inn, and similar names.

e.g., the State Lake Theater; (4) to attract attention, arouse curiosity, or in some way aid in bringing about the recognition or identification of the establishment, *e.g.*, window displays, decorations, and signs of various kinds; (5) to create an air of distinction or to create a favorable impression in the mind of the prospective buyer by suggesting exclusiveness, trustworthiness, quality, or service; (6) to aid in securing publicity, either through the press or by word of mouth among people generally; and (7) to tie up the various retail stores of a chain, or to tie up an individual sales place with the national advertising of some manufacturer.

Essential Characteristics.—If identifying features of sales places are to justify their costs of construction, operation, and upkeep, they must be *appropriate* and *distinctive*. Whatever the distinguishing feature used, it should be in harmony with the nature of the business, the character of the location, the quality of the clientele to which the management caters, and, of course, should comply with certain legal and social standards. Identifying features quite appropriate for a garage might be entirely out of place if applied to a bank or a millinery shop; what would be acceptable on Broadway might be shunned on Fifth Avenue; a style of architecture suited to the climate of Los Angeles might be inappropriate in Minneapolis. When names are used, they should be pleasing, euphonious, easy to pronounce, easy to remember, and distinctive.

The Factor of Cost.—A firm could, no doubt, design countless ways and means of identifying its sales place through various non-functional additions to the building, different styles and types of architecture, and divers unique ways of presentation, yet the cost of such features would be so great in proportion to the increase of sales resulting therefrom as to be prohibitive. There is probably no way in which the effect upon sales of any given identifying device can be measured quantitatively since the causal factors are so complicated and involved that they defy isolation and measurement. The difficulty of determining the exact or even approximate sales value of the identifying features of the sales place presents a troublesome administrative problem in determining how much can or should be appropriated for identifying features and how much for upkeep and operation. Some executives have designed their buildings, for instance, with little concern for their commercial value; they have been more interested in constructing a monument to their past success.

Identifying the Product.—Producers, merchants, and associations use brands, trade names, trade-marks, and distinctive packages to identify a large variety of merchandise. The practice is followed most extensively in the sale of food products, clothing, electrical equipment, hardware, drug and toilet goods, soap, and tobacco products. Agricultural

and natural products, however, are sold chiefly in bulk and are unidentified as to producer. A few of the cooperative associations producing citrus fruits, raisins, grapes, nuts, potatoes, asparagus, apples, melons, berries, and dairy products are now practicing this method of sales promotion in a modest way. The volume of sales of identified goods, however, in relation to the total sales volume of all goods is small. Many identified goods assume a position of greater importance in the buyer's mind than their relative sales volume warrants, because they are aggressively advertised.

Why Some Goods Are Not Identified.—Some goods are purchased on standard specification. In such instances branding may be of no advantage. Some products vary so in quality, size, shape, color, and in other essential features that they are difficult to standardize. Since standardization is an essential feature of branding, this is a serious limitation. There is a considerable demand from wholesalers and retailers for unidentified products. Merchants sometimes want to attach their own brands. Since many manufacturers selling nationally advertised goods object to having the price cut on their merchandise, some merchants desire an unidentified product or a private brand on which they can cut prices to meet competition.

A number of manufacturers who might otherwise identify their goods hesitate to do so because of the large financial outlay necessary to aggressively advertise the brand and to secure wide distribution. There appears to be small value in branding a product if the identifying feature is not made the subject of advertising, personal selling, and dealer helps. Unidentified goods are typically sold on a price basis. Branded goods are more frequently sold on a market price-plus basis.

Identifying Books.—The sale of books of fiction may be materially affected by the title chosen. The following quotation illustrates the use of the name or title of a book to aid in developing a demand.¹

Few readers, I believe, have a conception of the importance of a good title on a book. A fitting and an artistic title can help a book the way proper clothes can help a woman to accentuate her beauty.

I do not mean, of course, that a fine title will save a poor book but I do mean that a poor title may condemn a good book to oblivion. Frankly, I am a crank on this subject and retitled many books which we published.

For example, we once had offered to us the memoirs of a young Englishwoman, entitled "The Autobiography of a Minister's Daughter." The book itself, I felt, had charm, freshness and considerable humor, all of which were vitiated by the label. We drew up long lists of suggestions and finally rechristened her book "Merrily I Go to Hell." The practicability of our efforts was

¹ BRENTANO, LOWELL, in *Forum Magazine*. Quoted from *The Milwaukee Journal*.

demonstrated by the fact that after publication a motion picture company bought not the book, but the title.

What I am trying to say, in brief, is that I believe a successful title could, at least by implication, be descriptive of the contents of the book and at the same time pique the reader's curiosity. Titles, like women, should, I think, have both glamour and lure—lure, that is, for the pocketbooks of the readers.

Despite the huge success of "Babbitt," "Arrowsmith," and now "Anthony Adverse," I personally have a prejudice against name titles, except for biographies. I have a feeling that most people have poor memories for names and that, similarly, few names are sufficiently distinctive and fitting to be coupled instantly with a certain individual. All of us, for example, have had the experience of going to a social or business gathering, there to be introduced to a number of people in rapid succession. Afterward we try to classify the various people we have met and to attach them to their names. Unless your mind works more accurately than mine, the result is a dreadful blur. But everyone remembers the girl in the red hat, the man with the horse nose, and the laughing lady. That is why, visualizing the hundreds of books picked up in shops, like strangers awaiting an introduction, I prefer titles to challenge and hold the attention.

Why Goods Are Packaged and Branded.—Identification is used chiefly as a means of establishing and maintaining a higher degree of control over prices, demand, and trade channels than might otherwise be possible. Many sellers attempt to get away from price competition through improving and standardizing the quality of their product, then identifying it by means of a distinctive package or by attaching to it a brand or name. This gives the seller an opportunity to talk about the good qualities of his product. He can use advertising or salesmen or both to carry his message to the consumers and to the trade.

The manufacturer may be able, through advertising, to create such a desire for his particular brand that the buyer will call for it by name, or accept it without protest or argument when it is offered for sale by the retailer. When the consumer sees the package displayed in the dealer's window or on his shelves, he may recognize the brand from advertising which he has seen in magazines and newspapers. If the advertising has been effective, the consumer will probably buy. It is easy for one satisfied customer to tell another about the product when he can call it by name. It is more difficult for an unscrupulous retailer to sell the customer an unbranded article or one of an unknown brand after the purchaser once learns the quality of the established product.

Branded merchandise of good repute tends to reduce the retailer's selling costs because he can make more sales in less time. The customer is already "sold," so the retailer does not have to consume his time or that of the consumer in trying to persuade him to buy. When goods are in package form the retailer does not have to take time to weigh and wrap, as is the case when selling from bulk. This is a convenience to both the retailer and the consumer.

Protects the Consumer.—If the purchaser is satisfied with the product, he can reorder with fair assurance that the next purchase will be as satisfactory as the first. Identification, then, may serve as a form of protection to the buyer. When he purchases unidentified goods, he may or may not be satisfied. Unless he is an expert in judging the quality of the unbranded product, he will have to wait when he buys an unbranded article until he uses it before he can judge its quality.

The Development of the Practice of Branding.—The practice of branding was probably initiated by manufacturers who desired to develop national distribution with the aid of national advertising. As is usually the case, the early users were highly successful. They were able to establish a quality atmosphere about their products and secure the support of both the consumer and the trade. The package, in addition to identifying the product and carrying a valuable advertising message, may protect the product from waste, spoilage, and dirt; it makes handling convenient and saves time. People are willing to pay more for an identified, packaged product of uniform quality than for the unbranded bulk product of uncertain quality. Some firms which produce a number of products use an individual brand for each; other firms attach the same identifying feature to all. A few firms have grouped related goods in one line and applied the same brand to the group or "family" of products.

In the course of time, however, manufacturers who identified their products tended to reduce the wholesaler's and retailer's margins on the basis that the national advertising of the producer was performing a larger portion of the selling activity; consequently, the merchants were doing less. With lower selling costs they were enjoying a wider margin at the expense of the advertiser. The manufacturer then wanted to dictate the resale price. These practices did not please many of the retailers.

So many manufacturers, small ones as well as large ones, began branding merchandise that if a merchant attempted to carry all brands, he found himself overloaded with great varieties of brands of the same kind and quality of merchandise. A number of manufacturers created ill will among wholesalers and retailers by resorting to what is known as "full-line forcing." The producer had perhaps one or a small number of brands or articles which were well known and popular among the trade and consumers. He might bring out a new product, or there might be among his family of products some which were not wanted by the merchant or the consumer. The manufacturer would, however, bring pressure to bear on the merchant, virtually forcing him to stock the unknown or poor-selling product. Thus in order to get the good sellers he would have to take the slow sellers. Some merchants, both among wholesalers and large-scale retailers, attempted to meet the unsatisfactory situation by substituting, where possible, unbranded goods or their own

private brand for the manufacturer's identified products. They did this because the profit margin was greater and they trusted to their own sales-promotional activities to secure volume. Some retailers used the nationally advertised goods as leaders offered at low prices to draw customers into the store, and then they attempted to sell some of their long-profit merchandise.

Private Brands.—Wholesalers, some large-scale retailers, voluntary chains, and retail buying associations are active in adding to the confusion by placing so-called private labels on a great variety of products, especially in food and drugstore lines. The voluntary grocery chains and alliances are pushing their own private brands vigorously. The independent store owners who are members of these organizations see in these private brands an opportunity to secure the advantages of identified merchandise without paying such a large charge to the manufacturer. Some of the national advertisers in the food line sell unbranded goods, which later receive the private labels, to these organizations. The orthodox chain stores have developed private brands, but are not pushing them as aggressively as the voluntary chains. They still stock a large proportion of nationally advertised goods. These chains probably feel that they will profit most by taking advantage of the consumer goodwill established by the national advertisers.¹ The large department stores and the mail-order houses depend largely on their own prestige and, to a limited extent, on private labels and national brands. They may own some factories, but typically buy their merchandise from relatively small producers who do not attempt to identify and advertise their goods. The large-scale retailers frequently buy some unbranded merchandise as well as some branded goods from the national advertisers.

The Battle of the Brands.—The problem that confronts the retailer and the consumer when they buy is indicated by the following data on the great number of brands offered, on the dates indicated, by the retail stores of Milwaukee.²

In some instances as much as 90 per cent of total purchases were of one brand; in a number of instances the first choice brand accounted for two-thirds or more of total purchases. These facts suggest the small volume of sales the remaining brands are able to secure.

The point has long since been reached where neither the retailer nor the consumer can hope to be able to know or remember all the brands

¹ Consult "National Brands vs. Private Labels in Dealer Advertising," published in *The New Era in Food Distribution*, June, July, August, 1930.

Recent disclosures suggest that one important explanation for the friendly feeling of the large chains for the identified products of the manufacturers may be the large discounts allowed the chains by these manufacturers.

² "Consumer Analysis of the Greater Milwaukee Market, 1935," *The Milwaukee Journal*.

in many important lines of merchandise. The degree of competition among the brands has become so intense that there is little doubt that a great amount of economic waste in the execution of the sales-promotion activities exists. One can hardly see the justification for 10,000 brands of wheat flour or of 4,500 brands of canned corn. There were, in 1927,

INCREASE IN THE NUMBER OF BRANDS¹

Product	Number of brands		
	1935	1934	1931
Canned soups.....	50	44	21
Bottled catsup.....	76	63	54
Packaged tea.....	82	68	70
Packaged coffee.....	148	127	101
Wheat breakfast foods.....	29	30	26
Canned milk.....	39	37	22
Wheat bread.....	27	33	36
Baking powders.....	44	58	37
Packaged bacon.....	31	30	24
Prepared mayonnaise.....	53	46	38
Regular milk (no. of dairies).....	...	43	28
			(1927)
Packaged cheese.....	43	48	36
Packaged butter.....	...	162	93
Toilet soap.....	86	78	65
Soap powders and softeners.....	...	96	77
Cigarettes.....	29	27	20
Tooth paste.....	99	102	76
Tooth powder.....	63	47	36
Shaving creams.....	100	100	73
Packaged macaroni.....	108	95	60
Safety razors.....	37	53	24
Razor blades.....	127	119	43
Electric washing machines.....	141	142	110
Electric refrigerators.....	...	49	18
Radios.....	254	280	

¹ There were at one time as many as 10,000 brands of wheat flour, 2,500 brands of perfume, 4,500 brands of canned corn, 1,426 brands of toilet cream, 1,200 brands of face powder, and 1,000 brands each of canned peaches, canned salmon, and tea being offered the consumers of the country. *Advertising and Selling*, p. 20, Nov. 2, 1927.

seven different types of dentifrices sold under 402 brands, 164 of which were for pastes; yet, according to some estimates, one out of four people in the United States did not brush his teeth.

When brands are multiplied to such an extent that there is little or no distinction among them, they lose much of their economic value. The consumer regards the merchandise as *about equal in quality* despite the lusty claims of the army of labelers. Competition, as a result, tends to

go on a price basis, quality deteriorates, the cost of selling goes up, and profits go down.

Sales Promotion by Mail.—The method of promoting sales by using mail communication has a number of distinctive features. It has also some of the characteristics of the salesman and some of space advertising discussed previously.

Uses of Mail Communication.—This form of sales promotion is used (1) to make sales directly, (2) to create and maintain goodwill, (3) to make adjustments and correct misunderstanding, and (4) to supplement other forms of selling activity. Thus letters may be used to introduce a salesman, announce his anticipated call, and to keep the prospect interested between the calls of the salesman. Mail communication is used to follow up space advertising by soliciting orders from the individual whose name was so secured;¹ by sending out, promptly and economically, the information promised in the advertising; and by sending house organs and other goodwill-building literature. It is used to educate the salesmen and the dealers, to promote the proper use of dealer helps, and to distribute samples.

Classification of Mail Communications.—The chief kinds of mail communication are letters, catalogues, booklets, house organs, mailing cards, broadsides, folders, blotters, and a large variety of novelties. Each form has certain peculiar features that make its use desirable under favorable conditions.

The individually dictated letter, for instance, may be given a personal touch second only to that obtained by the use of the salesman. Personalized form letters lose something of this personal touch, but the lower production cost makes their use advisable when a large homogeneous group of prospects is to be contacted. The catalogue gives the seller much more liberty in presenting his sales story than the limitations imposed by newspapers and magazines allow. He can choose the quality of paper, printing, and art work best suited to his needs. He can say what is best for his sales proposition in the most effective manner. The cost per sale finally consummated is probably less than that of space advertising. Picken estimates the cost of letters at \$30 to \$100 per thousand.² The cost of selling by direct mail is said to depend largely upon the size, amount, and quality of material used.

Characteristics of Mail Communication.—The chief advantage of this form of sales-promotion activity is its flexibility. It can be designed and adjusted to fit special situations and the characteristics of a given group of prospects. There are, however, definite limitations to its use. The

¹ The names are received through the return of a coupon, or a request for a booklet, folder, picture, or some bit of information which has been offered in the advertisement.

² PICKEN, J. H., *Principles of Selling by Mail*.

characteristics of some products and services prevent the successful use of mail communication in making the sale, although it may be used to develop interest and secure inquiries. The letter, for instance, will sell only a fraction of the number of prospects that can be sold by the star salesman. A letter obviously cannot readily meet objections, answer questions, and otherwise adjust the message to the immediate whims and caprices of the prospect.¹

The seller can control the circulation of his mail communication by constructing his mailing list according to geographical divisions and types of businesses, or by professional, social, and financial groups. If the list is constructed carefully, and frequently revised there will be little waste circulation.

The time when the prospect receives the message can be accurately controlled. The day of the week and, in many instances, the time of the day when the material will reach the prospect can be predetermined. Experience shows that Tuesday is perhaps the best day of the week for the mailing to arrive, as the recipient typically receives the least amount of mail on that day; consequently, he is likely to give more attention to each piece. The other days, in the order of their preference for receiving mail communication, generally speaking, are Wednesday, Thursday, Friday, Saturday, and Monday.²

The following comparison, prepared by the S. D. Warren Company,³ brings out the strong and weak features of space and direct or mail advertising. This comparison indicates rather strikingly how each may supplement the other.

COMPARISON OF CERTAIN FEATURES OF SPACE ADVERTISING WITH THOSE OF MAIL COMMUNICATION

SPACE ADVERTISING

DIRECT ADVERTISING

a. Circulation

Inflexible. Mailing list is provided by the publisher. Advertiser must accept exactly the quantity offered. He cannot pick and choose except that he can select a magazine or a newspaper with a definite kind of editorial content, appealing to definite classes of readers.

Flexible. The advertiser can select his own circulation or mailing list by communities, by businesses, by professions, by social, or executive positions.

b. Mailing Dates

These are set by the publisher.

These can be exactly suited to the work in hand.

¹ *Ibid.*

² *Class and Industrial Marketing*, p. 129, January, 1928, quoting Charles Lubin, assistant postmaster of New York City.

³ *Booklet 1*, p. 5, S. D. Warren Company, Boston. This company sells paper.

c. Timeliness

Closing dates of magazines often prevent taking advantage of items of immediate news interest. The advertiser in the daily newspaper can use copy of immediate news interest.

Items of immediate news interest can be put into type and mailed while the interest is keen.

d. Unit of Space

Advertiser must use the units of space determined by the publisher.

This can be whatever size and shape seem desirable for the presentation of the subject under discussion.

e. Printing Treatment

The advertiser must be guided by rules established by publishers regarding ink, type, and paper.

This can be whatever is necessary or desirable to promote the particular subject being promoted.

f. Cost per Unit

The per unit per reader cost of space advertising is low—especially when each one of the entire reader group is a possible purchaser, or influences possible purchases.

The per unit per reader cost of direct advertising may be low or high according to the character of the mailing. On envelope enclosures and package inserts, where carrying charges are already paid, for instance, the per unit charge can be very low.

g. Advertising Competition

Magazines and newspapers carry advertising of competitors and of many other businesses.

Direct advertising pieces usually are devoted exclusively to the business of a single advertiser.

h. Information to Competitors

In a space campaign the scope and character of the effort is usually apparent to competitors.

In a direct advertising campaign, the scope of the effort is not apparent to competitors. The list may comprise one section of the country or all sections. It may comprise 100 names or 1,000,000 names.

Coordination of Salesmen and Mail Communication.—The experience of a hardware manufacturer will serve to illustrate how effective coordination of salesmen and mail communication may reduce the costs of marketing. This producer found upon investigation that 72 per cent of his sales were secured in large cities, and 28 per cent from widely scattered small communities visited by his salesmen. Because of the high selling cost, he decided to discontinue sending salesmen to the small towns and confine his selling activities to the large cities. This did not produce the anticipated reduced costs. Other manufacturers were

apparently following a similar plan. Sales in the cities increased, but lower prices, due to keen competition, reduced profits. He then decided to reenter the small-town market through mail communication and continue the use of salesmen in the large cities. Within one year the mail sales amounted to 42 per cent of his total sales and were secured at a cost of 4.05 per cent of sales against a cost of 10 per cent for the 58 per cent secured by salesmen.¹

Chart XIV, on the following page, indicates how the Armstrong Linoleum Company coordinated certain elements of its sales-promotion activity. This plan shows how effectively these various activities can be synchronized when the peculiar attributes of each are clearly recognized, and are used accordingly.

Cooperative Sales Promotion.—The increased competition between industries, the situation that exists when the products of one can be substituted for the products of the other, has led to cooperative sales-promotional activities among manufacturers within an industry. The producers form what has come to be called an *industrial institute*. These organizations frequently formulate and conduct national advertising campaigns for the purpose of increasing the sales of the products of the industry. The greeting card manufacturers, according to reports, increased their sales 400 per cent in six years; the Oak Flooring Bureau increased the sales of its product 800 per cent in a period of a few years; the American Face Brick Association expanded the combined sales of the manufacturers $2\frac{1}{2}$ times in four years. Cooperative advertising has been effective in such widely different industries as sauerkraut, flowers, terra cotta, wallpaper, citrus fruits, dairy products, bananas, brass and copper, and steel. This form of sales promotion has been chiefly educational in character. The objective has been to show how and why the particular product was of great value to other industries or to the consumer. The industries that have formed these institutes for cooperative purposes have typically been ones that have seen their own sales decline, or not grow at the rate anticipated, because of the popularity of the product of some other industry.

Coordinating the Elements of Sales Promotion.—Successful marketing depends upon carefully selecting and properly balancing the instruments of sales promotion. If overemphasis is placed on the use of some and others are largely ignored; if they are employed at the wrong time and place, or in an ineffective manner, costs are likely to rise unduly. The best planned and executed sales-promotion campaign cannot, however, stimulate an appreciable sales volume over a long-run period for

¹ *Advertising and Selling*, p. 22, Jan. 12, 1930. A large manufacturer of overalls, located in Wisconsin, succeeded in reducing his selling costs by following a somewhat similar plan.

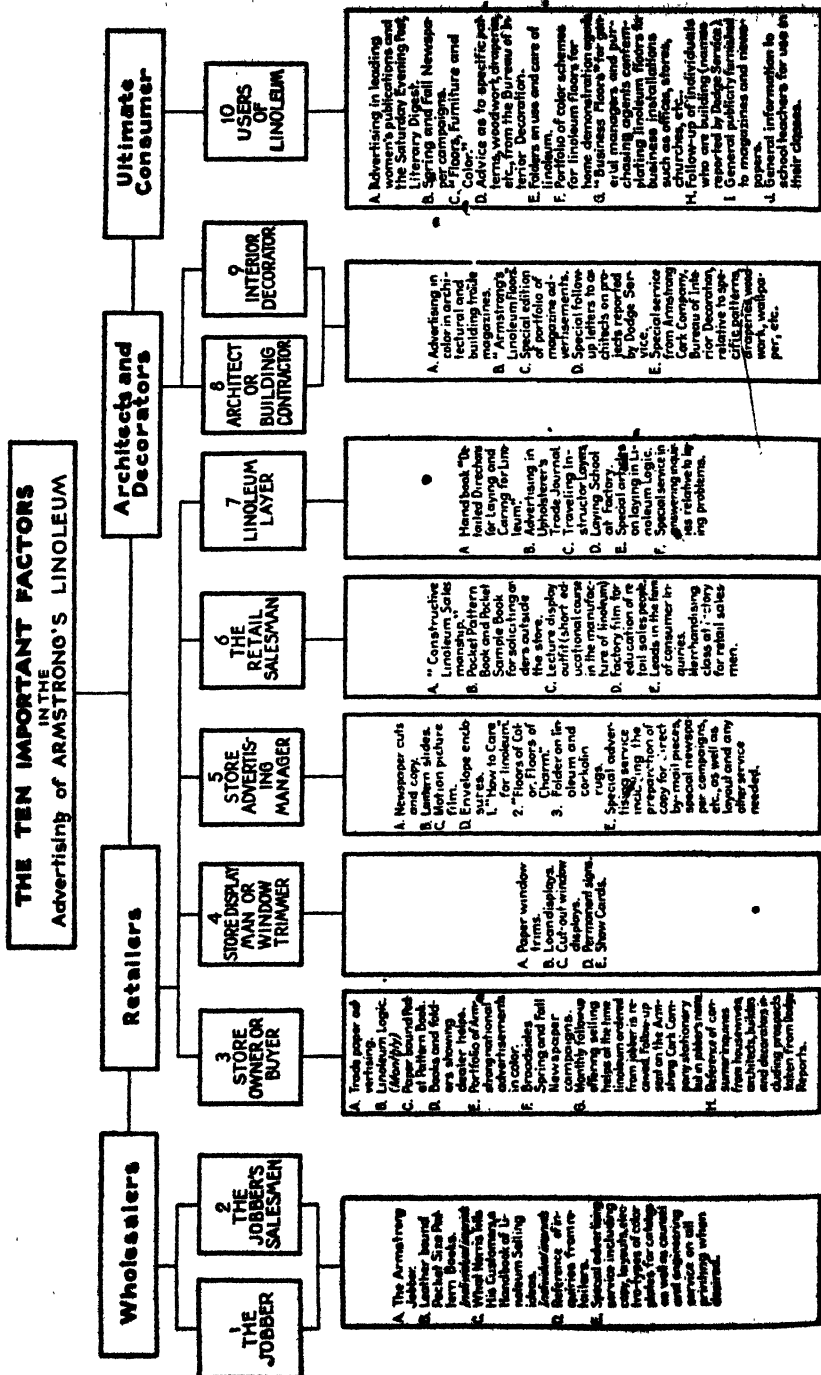


CHART XIV.—An illustration of coordination in sales promotion. (Booklet 2, p. 35. S. D. Warren Company.)

a product without merit or one for which the public has no natural or acquired desire.

The operation of a plan that coordinates salesmen, space advertising, mail communication, dealer helps, window and counter display, and outdoor advertising is illustrated by the following quotation.¹ The ideal, according to this statement, is

1. To have a possible customer pick up a magazine or newspaper, read the seller's advertisement, be impressed with a need for the product.
2. To have the prospect receive about at that moment a folder or booklet from his or her favorite retail dealer, telling the advantages of this same product.
3. To have the prospect go down to the dealer's store, be reminded again of this same product by a sign on the window or a display of goods in the window.
4. To have the dealer's clerk suggest to him or her the purchase of this product, pointing out its advantages and merits.
5. To have the prospect buy the product and take it home, and on opening the bundle or package, find an insert rehearsing the story of the product and its uses.
6. To have the prospect, after reading this carefully, go out and boost the product to friends.
7. To have the prospect and friends of the prospect use and reorder the product.

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¹ Booklet 1, p. 7, S. D. Warren Company, Boston.

Questions for Discussion

1. What is meant by the term *sales promotion*? Compare and contrast the characteristic features of each selling activity included under the heading, sales promotion.

2. What is the relation between mass production and mass distribution?

3. "In general, it may be said that the efforts to improve personnel in distributing houses, whether they are wholesale or retail, fall into three general groups: (a) the devising of a bonus or premium system by which an additional wage is made an incentive for increased sales effort, (b) education for the purpose of raising the standard of ability of employees, (c) the standardization of instructions for the purpose of reducing error, such as is to be found in manuals and books of instruction for sales-people." Does society receive any benefits from these educational activities of business?

4. "The mere fact that the institution is large, and that the number of employees is too great to make personal contact with the employer possible, introduces another group of problems. Even more important than this, from a marketing point of view, is the fact that in such institutions selling costs, and particularly, sales wages, tend to rise year by year more rapidly than they do in smaller concerns." What are the causes of this situation? How does this fact affect the administrative task of the large-scale seller?

5. "The principal requirement is that those who conduct the sale shall possess certain fairly well-defined qualities which go to make up the good salesman." What is a "good salesman"? What are the "well-defined" qualities? How does a person obtain these qualities?

6. "The main problem is to find salesmen who can sell goods and then pay them enough to make it worth while for them to stay with the concern." Is it as simple as this statement implies? Justify your answer.

7. Some department stores place great emphasis upon establishing good relations with the public. How is this activity connected with the sales problem?

8. How do you account for the fact that the use of advertising as a sales-promotion device has been more severely criticized than has the use of salesmen? Which device, do you think, is more expensive? Which is more likely to be abused? Why?

9. "... advertising is waste. The millions that have gone into it might better have been used in ways that would be constructive. In justice to the people, the tremendous amounts of money that are spent in advertising ought to be passed on to the consumers, either in the form of lower prices, or in the form of more adequate values." Examine this quotation in a critical manner, and then state your opinion as to its correctness.

10. "All national advertising tends to create vicious chains in which the increase in national advertising appropriations by manufacturers tends to increase the price level of all goods." Do you agree? Justify your answer.

11. "For purposes of showing its economic status, advertising may be divided into two main classes: (a) advertising in which all concerned in the process in which it is used regard their part in the advertising process as a legitimate factor used legitimately for legitimate ends, and (b) advertising in which either the seller of advertising or the user of it is using it for desired results without strict regard for the welfare of the other parties to the process, the consumer being regarded as being included in the process. Roughly speaking, this type may be divided into three classes: (1) where those paid for the advertising are victimizing the advertiser, (2) where the advertiser is victimizing the consumer, and (3) where advertising is used for political purposes or for raising money for unjustifiable ends." Evaluate these statements. Cite examples from your own observation.

12. "The great increase in the amount of advertising in the past half century and the apparent prosperity of most companies that have advertised persistently may be accepted as evidence that advertising benefits those who use it." But are their profits offset by the losses of others? Is our \$2,000,000,000 annual expenditure for advertising a tax upon the public? And if wholly or partly a tax, does it benefit society enough to justify it? In short, does advertising make for public welfare?

13. "Advertising, if it is successful, enables the advertiser to increase the proportion of business which he does and to decrease the proportion of business which his competitor does, but it cannot increase or decrease the total amount of business which is done by all of them." Analyze this quotation. Does it correctly state the case?

14. Compare and contrast publicity and advertising.

15. What are the various methods of identification used in marketing? What is the purpose, in general, of using identifying features?

16. "The consumer has a right to know where and by whom the goods are produced and the producer has a right to have his name on his own goods." Do you agree? Justify your answer. How would the exercise of such rights affect the use of private brands?

17. "Brand specification, as the term is used by advertising men, describes the habit of buying by specifying a brand. Standard specification, on the other hand, may be described as the specifying of established standards in buying." Brand specification and standard specification "are really diametrically opposed." Do you agree? Justify your answer.

18. Why have some wholesalers found it advisable to develop their own brands? Upon what type of goods do wholesalers usually place their private brands? How does the use of the brand by the wholesaler affect the *price* and the *quality* of the goods?

19. "Brands protect both the consumer and the manufacturer or distributor." How is this possible?

20. How has the increased use of brands affected marketing problems? Have the interests of the consumer been adequately safeguarded in the mad scramble to use more and more brands? How has the cost of marketing been affected?

21. Explain the attitude of the manufacturer, the wholesaler, and of the retailer toward branding.

22. "The irrationality of consumers and their susceptibility to suggestion in their consumption provide an opportunity for the individual business man to increase his sales through aggressive advertising and salesmanship." What of it?

23. "Much sales effort is concerned with lessening the utility of goods which are already possessed by the consumer." How is this done? Is the practice economically justifiable? Why?

24. "The problem is how to mobilize the potential market; how to convert mere desire into active demand; how to enable it to enter the market place and make the market absorb all that we can ever produce." How is the problem being met? Is this the best method?

25. "What a healthier and happier nation ours would be if the number of artists, physicians, farmers, and mechanics were increased, and the number of salesmen and clerks decreased." Do you agree? What point of view is indicated by the quotation? How could this be accomplished? What would be the effect?

26. "Unfortunately, the pressure upon the producer to sell is so much greater than the capacity of the consumer to buy that high-pressure methods of selling have invaded pretty nearly every industry." How is the term "methods" used in this statement? What is the economic effect of this condition? What specific forms have these high-pressure methods taken?

Assignment

1. Problem 3, p. 589. Bigelow Furniture Company—Sales Promotion.
2. Problem 1, p. 490. Glenrock Manufacturing Company—Method of Paying Salesmen.
3. Problem 1, p. 614. Touraine Company—Advertising.
4. Problem 2, p. 586. Sucrosa Sugar Refining Company—Advertising.
5. Problem 1, p. 581. California Fruit Growers' Exchange—Sales Promotion.
6. Problem 2, p. 555. Hillary, French & Company—Private Brands.
7. Problem 1, p. 559. Ostend Pork Products Company—Use of a Blanket Trade-mark.
8. Problem 2, p. 563. Sheridan Chemicals Company—Use of Trade-marks.

CHAPTER XIX

PROBLEMS OF AGRICULTURAL COOPERATIVE MARKETING

Purpose of this chapter: To survey the extent and analyze the causes of the growth of agricultural cooperative marketing, and to examine some of the major problems of organization and operation.

The organization of cooperative associations by farmers for marketing purposes has grown steadily since 1918. The substantial and extensive development gives strong support to the contention that the agricultural cooperative movement is economically sound and socially desirable.

A farmers' cooperative marketing association is an organization set up for the purpose of selling farm products and returning to producer members their full share of the money paid for the products by consumers. Farmers come together and form cooperative marketing associations chiefly to get more for their products than they are paid by private buyers.¹

The farmers' cooperatives are concerned with marketing farm products, purchasing farm supplies, providing credit and finance for the production and marketing of farm products, and furnishing telephone service, electric current for light and power, water for irrigation purposes, transportation service, and insurances at cost.

Farmers show more interest in the cooperative movement during periods of low prices. Although this type of organization has enjoyed its most rapid growth since the war, it had been developing slowly and intermittently for a century or more prior to this period. Since the cooperative movement in the United States has been influenced to a considerable extent by the success of the Danish cooperatives, we shall survey briefly some of the experiences of Denmark.

The Danish Cooperative Movement.²—The Danish movement, unlike the English, started among the farmers. The idea first found expression through the cooperative credit associations established about the middle of the nineteenth century. Cooperative retail stores were organized in 1866; the first creamery was started in 1882, and the first bacon factory came into existence in 1887.

¹ "Cooperative Marketing of Farm Products—The Story of American Farmers' Marketing Organizations," p. 1, *Federal Farm Board, Bull.* 10, 1932.

² The data on the Danish cooperative movement is adapted from "Agricultural Cooperation in Denmark," *U.S. Department of Agriculture, Bull.* 1286, prepared by Chris L. Christensen.

The cooperative plan has been utilized more intensively in Denmark than in any other country. The membership comprises more than 205,000 farmers, approximately 85 per cent of the total number in the country. There were more than 5,000 associations in operation in 1920. A Danish farmer sometimes belongs to as many as eight or ten associations.

Conditions That Promoted Cooperation.—The people of Denmark were practically forced into farming because of the lack of fuel, power, and mineral resources. The country suffered severe economic reverses due to wars with Germany during the middle of the nineteenth century; decreased fertility of the soil, the result of continual grain production; and the low European prices of agricultural products, the result of the great exports from America. The people wisely decided to shift from grain farming to animal production. The trouble with Germany caused the Danish farmers to look toward Great Britain as a market for their butter, bacon,¹ and eggs. The production of animal products for export required capital, which could be more easily secured through cooperative effort. The export market demanded high-grade products of uniform quality; cooperative effort seemed to offer the best way of providing these requisites. Today farm products are marketed cooperatively, supplies are purchased cooperatively, bacon and butter are produced in cooperative plants, and credit is secured from cooperative banks. The cooperative creameries sell much butter directly to other cooperative associations, for instance, to the English Consumers' Cooperative Wholesale Society, Manchester.

Various groups of cooperatives have formed federations for general service purposes. A central organization, the Federated Cooperative Association, was organized in 1917. It comprises sixteen cooperative federations and large cooperative enterprises, such as the Danish Cooperative Bank. Its policies and activities are directed by the Central Cooperative Council, which is made up of representatives from the various cooperative federations.

The Elements of Danish Cooperation.—There are certain definitely defined characteristic features common to all the Danish agricultural associations. They are strictly business organizations developed independently of state, political, religious, and social-class point of view. They receive no financial aid from the state. The organization of an association depends upon the assurance that there is enough business available to permit economical operation. There is no attempt to

¹ Hogs are raised to utilize the large quantity of skimmed milk that comes from the creameries. The bacon-type hog is produced so as to meet the tastes of the English market. The Danish practice furnishes an interesting illustration of the profitable utilization of what otherwise would be a waste product. It also shows how the farmers have adjusted their production to meet the demand of the market.

membership. Approximately 10,900 cooperative associations during the crop year 1933-1934 had an estimated membership of 3,156,000, and did an estimated business of \$1,365,000,000. There were in 1933 approximately 4,817 associations with a membership of 1,072,350 that did a business of \$372,030,000 in the West North Central division of the United States, and 2,971 with a membership of 831,430 with estimated

TABLE 84.—NUMBER OF FARMERS' MARKETING AND PURCHASING ASSOCIATIONS, ESTIMATED MEMBERSHIP, AND ESTIMATED BUSINESS, BY COMMODITY GROUPS, FOR THE UNITED STATES*

Commodity group	Listed ¹		Estimated membership ²		Estimated business, in \$1,000	
	1933	1934	1933	1934	1932-1933	1933-1934
Cotton and cotton products	274	250	200,000	200,000	42,000	100,000
Dairy products.....	2,293	2,286	724,000	757,000	390,000	380,000
Forage crops.....	33	32	7,800	7,600	1,500	1,800
Fruits and vegetables....	1,268	1,194	170,000	185,000	200,000	182,000
Grain ³	3,131	3,178	600,000	600,000	280,000	285,000
Live stock.....	1,575	1,371	440,000	410,000	182,000	162,000
Nuts.....	65	57	17,500	15,000	8,000	11,500
Poultry and poultry products.....	154	147	78,000	73,000	53,000	48,000
Tobacco.....	20	16	60,000	46,600	6,500	5,500
Wool and mohair.....	115	120	62,000	63,800	0,000	13,700
Miscellaneous selling.....	424	401	98,000	106,000	17,000	23,500
Miscellaneous buying.....	1,648	1,848	542,700	692,000	140,500	152,000
Total.	1,000	0,900	3,000,000	3,156,000	1,340,000	1,365,000

* Adapted from *Yearbook of Agriculture*, p. 738, 1935.

¹ Including independent local associations, federations, large-scale centralized associations, sales agencies, and independent service-rendering associations, but not subsidiaries nor associations renting unsold property.

² Including members, contract members, shareholders, shippers, consignors, and patrons.

³ Including dry beans and rice.

business of \$317,110,000 in the East North Central division. These two sections accounted for more than 50 per cent of the number of association memberships and of the volume of business.¹ Some of these associations are local units engaged in assembling, processing, manufacturing,

¹ In 1929 there were approximately 12,000 cooperative associations with a combined membership of about 3,000,000 farmers, doing an annual business of approximately \$2,500,000,000. Part of the decline by 1933-1934 in number of associations was due to consolidation of smaller groups to form larger ones; the decline in dollar volume was due chiefly to the fall in prices. It was estimated that about 2,000,000 individual farmers were members of associations; some farmers belong to more than one association.

grading, packing, and shipping the products of the farmer. Recently there has been a decided trend toward grouping the local units into federated groups, with large central agencies which sell the products in the terminal markets and establish standards for grading and packing. There are approximately 200 large-scale cooperatives in the various commodity groups, which do more than one-third of the cooperative business. The formation of large-scale centralized commodity cooperatives was greatly accelerated during 1930-1932 under the aggressive leadership of the Federal Farm Board.

Reasons for Growth of Cooperatives in the United States.—Cooperative associations in this country were organized, as were those in England and Denmark, to overcome certain handicaps. The farmers were dissatisfied with the prices they were receiving for their products. Prices were low, partially due to over-production which resulted from the rapid settlement and exploitation of the fertile lands west of the Mississippi River. The middlemen retained a larger portion of the final price than the farmers thought they were entitled to, and railway rates were excessive and service frequently discriminatory. Competition among unorganized producers during periods of over-production usually drives prices much below the bulk-line cost of production. The originators of the cooperative movement were searching for a device with which to overcome these handicaps.

The Rate of Growth in the United States.—The first cooperative cheese factory in the United States was organized in Oneida County, N.Y., in 1851; by 1863 there were 500 producer-owned cheese factories in New York State alone, and by 1869 there were more than 1,000 in the United States. The first cooperative creamery was organized in Orange County, N.Y., in 1861. The first carload of live stock, hogs, shipped by a live-stock shipping association was from Superior, Neb., in 1883. It was not until 1894 that the second cooperative shipping association was formed; this one was organized by a group of Iowa farmers. The movement, however, did not really get under way until 1914.

One of the first cooperative fruit associations was the Fruit Growers' Union and Cooperative Society of Hammonton, N.J., which was formed in 1867 and continued in operation for thirty years. The citrus growers turned to cooperation for a solution of their difficulties in the early nineties. The growers believed that they were receiving too small a portion of the consumer's dollar. The middlemen controlled the situation and paid such low prices that the industry was facing ruin. The growers decided that the solution lay in devising a method that would permit them to receive the price paid by the jobber less only the cost of transportation and handling charges. The plan of cooperation which they developed and their method of operation proved highly satisfactory.

The first cooperative activity among the prune growers appeared in 1900. This attempt was short-lived due to the competitive practices of the large prune packers. The next attempt was made in 1917 when the California Prune and Apricot Growers' Association was organized. This association was planned by non-farmers, but followed sound cooperative principles. The association suffered severe reverses in 1920 and 1921 due to a mistaken policy based on the belief that it could fix prices.

The raisin growers, due to the high-handed practices of the packers, brokers, and dealers, were facing ruin until they turned to cooperation in 1913. A market analysis was made; the product was standardized, packaged, branded, and advertised nationally. The result was a great increase in sales. The association was successful in securing higher prices for the growers. The high prices secured in 1919 and early 1920 led to charges that the association was a monopoly acting in restraint of trade. The federal government brought suit against the organization and ordered it to change some of its practices. When the deflation of 1921 appeared, the situation was changed. The growers realized that they could not permanently fix prices. High prices had led to greatly expanded production; the natural result was a drastic fall in prices. The present policy is to control production and to promote efficient operation.

Cooperation among the cotton growers did not appear until 1920¹ when the Oklahoma Cotton Growers Association was formed. The success of this group caused the growers in other cotton-growing states to follow the plan. A comparatively small percentage of the total cotton crop, however, was marketed through cooperative associations during 1927 and 1928. The early cooperative leaders centered their attention on limiting production and on fixing prices. They were not successful in either. The cotton growers are dissatisfied with the existing system of marketing. They, in common with the grain farmers, have not been receiving prices commensurate with the costs of production.

The Use of the Cooperative Marketing Machine.—While it has been truly said that the essence of cooperation is *the spirit* and not *the form*, and that the type of organization is merely a means to an end, yet the structure and the operation of the vehicle that expresses this spirit are vital. The end may not be attained if a suitable means is not employed. The advantages and the limitations of this marketing agency should be carefully appraised. If this appraisal shows that the particular form of group action commonly designated as cooperation should be employed, then the type of organization best suited to the temperament and needs

¹ The granger movement had brought about a certain amount of cooperative marketing along with its other activities, but this ceased with the decline of the grange.

of the members, the nature of the product, the scale and character of production, and the nature of the demand should be developed.

A cooperative association can operate effectively for marketing purposes with the staple commodities when the total volume of production is large enough to permit economical handling; when grading and standardization are possible and desirable; when certain transportation, storage, and financing facilities are operated against the best interests of the producer; and when the available marketing agencies become unmindful of the economic interests of the producer. In short, there should be a definite need for the services a cooperative association can effectively perform.

The cooperative organization tends to reduce competition among farmers when selling their products. They sell as one group instead of selling as individuals, thus strengthening their bargaining position. The cooperative association secures certain advantages that go with large-scale operation and integration. It may act as a selling agent for the farmer; find him a buyer; furnish him with reliable market information; promote the establishment of standards, the practice of grading; and furnish storage, inspection, insurance, and financing services on better terms than can be secured from private sources. The live-stock cooperative shipping association, for example, assembles and ships the live stock of the farmer at cost. Marketing costs of fruit and vegetable producers have been reduced and cash returns have been increased by having the collecting, grading, packing, distributing, warehousing, financing, and selling of their products performed by cooperative associations. The management of the association is in a better position than the individual farmer to adjust shipments to day-to-day or week-to-week market demand. Some of the cooperatives have so graded and standardized their products that they can identify and advertise them. Effective cooperative advertising is being carried on by producers of citrus fruits, English walnuts, cranberries, and dairy products, e.g., Land O'Lakes butter, Diamond walnuts, and Sunkist and Sealdsweet oranges.

One of the most important services a cooperative performs is in passing back to producers accurate knowledge of what consumers want as to quality and quantity of products. So long as the producer receives "hog-round" prices for cotton, "mine-run" prices for eggs, or sells butter at the same price regardless of quality, there is little incentive to improve quality. Cooperatives enable producers to receive prices that are based on grade, quality, and variety so that they can afford to plan intelligent production programs in keeping with demand.¹

Limitations to the Effective Use of Cooperation.—There are, however, certain decided limitations to what can be attained. Farm products

¹ Federal Farm Board, Bull. 10, p. 3.

that cannot readily be standardized, and those produced in small amounts by widely scattered producers, can probably be marketed more economically through private agencies. A cooperative association cannot fix prices unless it can control production. This is extremely difficult to accomplish. The A.A.A., together with the droughts of 1933 and 1934, succeeded, but aroused a storm of criticism from urban consumers and many other interested or affected groups. The association may eliminate marketing functionaries although it cannot abolish functions. Its chances of reducing the costs of marketing below those of the independents depend largely upon more efficient operation. Success is limited by the degree of loyalty displayed by members and the grade of management exercised. The small local cooperative association is at a considerable disadvantage when compared with the large federated and centralized cooperatives. Other possible limitations to the activities of cooperative associations are the desire of people to save by performing certain services for themselves, the possibility of the state entering the business field, and the development of greater efficiency and superior management on the part of private enterprises.

The division of cooperative marketing, Federal Farm Board, warned the farmers not to expect the impossible by citing "what cooperatives cannot do for farmers."¹ For example:

1. The price a cooperative may obtain is limited by economic conditions over which the association has little, if any, control. Any organization can set a price on its commodities, but in order to sell all of its supply, prices must be such as economic conditions justify, or low enough to move the given quantity into consumption.
2. Cooperatives cannot entirely eliminate middlemen.
3. It is not always possible to obtain the cost of production for the products of each individual farmer or even for the products of the average farmer.
4. Cooperatives can not always get more for the products of its members and patrons than can be obtained by those who do not sell through cooperatives.
5. They cannot sell poor quality products for premium prices.
6. They cannot succeed without loyal support of members.
7. They cannot succeed without good management.

Types of Cooperative Organizations.—During the course of development different types of organizations have emerged. The first type was the local organization which was formed by a relatively small number of interested producers, or workers, as was the case in Rochdale. The local agricultural cooperatives perform such marketing functions as collecting, grading, packing, and shipping the products, and purchasing supplies for the members. They are limited, however, in the character of services they can perform. They cannot afford to brand and advertise

¹ Bull. 10, *op. cit.*, p. 9.

their small output; they cannot economically provide terminal market warehouse facilities and selling organizations; they cannot hire the highest type of managerial ability because of limited income; and they cannot maintain strong research, claims, and purchasing departments because of the high per unit overhead costs which are due to the small volume of business.

The tendency since 1925 has been for the membership and the volume of business to increase more rapidly than the number of associations. The cooperative units, in other words, are tending to grow larger. The size and characteristic organization of a cooperative association is determined by the nature of the product, the size of the

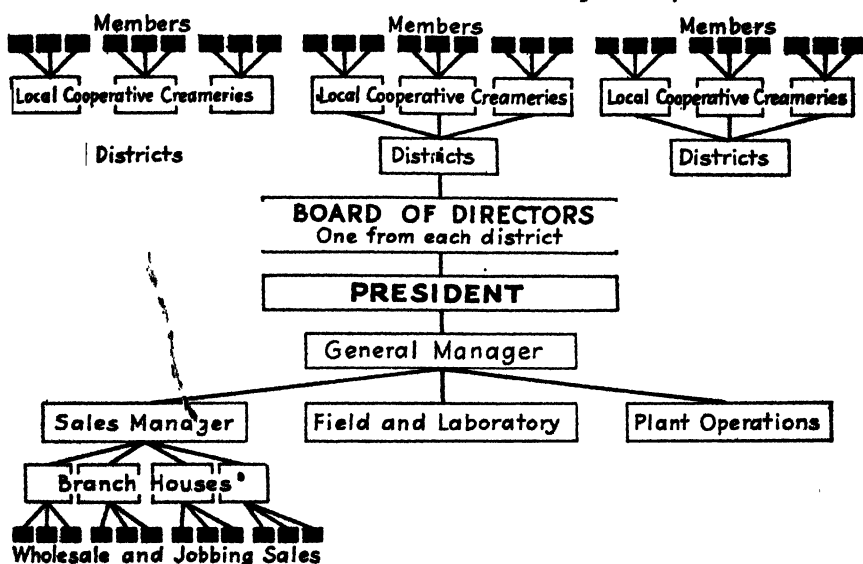


CHART XV.—Federated organisation. (Federal Farm Board Bull. 10, p. 18.)

producing area, the methods of production, harvesting, collecting, transporting, storing, financing, packaging, identifying, and selling. The objective is to reduce services and costs to only the essential ones, and to eliminate excess profits of middlemen; to give the producer a more satisfactory cash return and the buyer better quality at a reasonable price.

The Federation.—The limitations mentioned above tended to promote federation. Under the federated plan the locals are grouped into district organizations, and these in turn are united into a large and powerful central selling organization. These large organizations remain democratic institutions since the control remains largely with the locals. The federation depends on education, personal contact, and services satisfactorily rendered, rather than on laws and courts, to keep the

support and patronage of the members. This type of organization is especially well suited for staple products that can be standardized and can be marketed best through centralized marketing systems and still retain the local organizations. Two outstanding examples of this type are the California Fruit Growers' Exchange and the Land O'Lakes Creameries, Inc. Chart XV illustrates the federated type of organization.

The California Fruit Growers' Exchange is a non-stock, non-profit association with approximately 11,500 individual members, all of whom are citrus fruit growers. These members are grouped into 201 local packing-house associations, which in turn are combined into 23 district exchanges. Each of the district exchanges elects a representative as a member of the California Fruit Growers, Inc. Sales by this organization

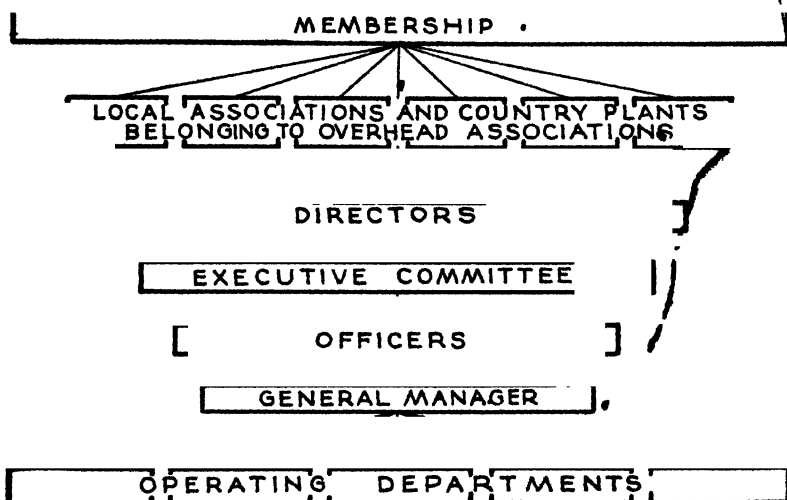


CHART XVI.—Centralized organization. (Federal Farm Board Bull. 10, p. 19.)

account for about three-fourths of the total California citrus fruit sales. The exchange has a nationwide sales organization which maintains a contact with 2,500 jobbers and 300,000 retailers.

The Land O'Lakes Creameries, Inc., has about 465 member creameries averaging 200 dairymen per creamery, or a total of 92,000 producers. Sales for 1929 probably exceeded \$50,000,000.

The Centralized Cooperative Association.—Another type of cooperative organization is the centralized form developed by the cotton growers, fluid-milk producers' associations, and the prune and apricot producers. There are no associations of local growers; the producers belong individually and directly to the central association. Chart XVI illustrates this type of association. Since these associations cover wide areas and may

have thousands of members; close personal contact is impossible. Long-term contracts and strong penalties for violation of the terms are used, in addition to the benefits derived from cooperation, to keep the support of the members. These organizations take title to the product as soon as it is delivered. The association assumes full responsibility for marketing and determines when to sell. The products of the entire area are usually placed in one pool. The management of the centralized type of cooperative organization assumes greater responsibilities and exercises greater control than the federated type. It relies more on contracts, liquidated damages, and the use of the courts than the federations.

The centralized form has been used more frequently with products that are difficult to grade and standardize, and that are marketed through decentralized exchanges. The goal of the federation is increased efficiency in marketing. The goal of the centralized type seems to have been price fixing through monopoly control. Recently there seems to have been a change in policy on the part of the latter group. They are striving more and more for efficiency in marketing, and are placing less reliance on the hope of being able to fix prices. They are also promoting the organization of local associations so as to exercise through educational efforts a greater degree of personal control over the members.¹

Any of these types of cooperative associations may be organized on a stock or on a non-stock basis. Which plan is used depends upon the need for capital, whether it is decided to raise these funds by selling stock or by some other method. The associations organized on a non-stock basis typically use subsidiary corporations to own and operate processing plants.

Problems of Organization and Operation.—Since the success of any cooperative movement depends upon so many factors, the organizers, executives, and members should be thoroughly familiar with the possibilities and the limitations of this marketing device. The legal, economic, social, political, and management prerequisites should be carefully examined and complied with. The organizers should be sure that adequate volume of business² is available, that sufficient capital

¹ There are two general classes of fluid-milk associations; the bargaining type, which makes contracts with distributing agencies and guarantees payment to the producers; and the operating group, which collects and distributes the milk. The latter may perform all the services of the first, since in its operation it must find markets and arrange terms of sale. *U.S. Department of Agriculture, Circ. 94, pp. 10 ff.*

² It was estimated that a cooperative elevator, for example, could handle wheat at a cost of 6 cents per bushel if the volume was 100,000 bushels annually; the cost would be reduced to 4 cents if the volume were 200,000 bushels. Local cooperative creameries should have a volume in excess of 200,000 pounds of butterfat annually; the centralized type must have a much larger volume. "probably 1,000,000 to 2,000,000 pounds." *Federal Farm Board, Bull. 11.*

for permanent facilities and current funds can be advantageously secured, that efficient and capable management can be provided, and, last but not least, that the membership will give loyal support. State and federal cooperative marketing laws should be carefully followed.

The Capper-Volstead Act, for example, provided that:

1. The association must have only producers as voting stockholders or members.
2. It must be operated for the mutual benefit of its members.
3. It must be engaged in interstate and/or foreign commerce.
4. The association must not deal in the products of nonmembers to an amount greater in value than those handled by it for members.
5. One of the following requirements must be met (it is preferable to include both):
 - (a) Each member or stockholder shall have only one vote;
 - (b) Dividends on membership capital or stock shall not exceed 8 per cent per year.

If a cooperative association meets the conditions specified in the Federal income-tax statute and regulations, it is exempt from the payment of income taxes. The conditions of this statute are not identical with the conditions of the Capper-Volstead Act. Hence, in order to secure exemption from Federal income taxes it is necessary to meet not the conditions of the Capper-Volstead Act but the conditions of the Federal income-tax act.¹

One might be justified in contending that a *good beginning* comprises at least half the requisites for success. The type of information needed to furnish a sound basis for determining whether a *good beginning* is possible is indicated in the following outline designed to aid the organizers of dairy cooperatives in making a survey of local conditions.²

HISTORY OF COOPERATIVE EFFORTS

1. What cooperatives are operating in the vicinity?
2. How long have they been organized?
3. Have their operations been successful?
4. What is the attitude of their members? (satisfied, loyal, dissatisfied, disloyal).
5. What are the reasons for the attitude of the members?
6. Have any dairy cooperatives failed in this or near-by communities?
7. If so, what were the reasons for failure?

ASSOCIATIONS HANDLING MILK AND CREAM FOR MANUFACTURING PURPOSES

1. Production.
 - a. Estimated daily production of butterfat sold locally, pounds.
 - b. Estimated daily production of butterfat shipped, pounds.
 - c. Number shippers selling cream in territory.
 - d. Seasonal variations in production.

¹ *Ibid.*, p. 2.

² *Ibid.*, pp. 6 ff.

- 2. Types of service now available.**
 - a. Are there any cooperative creameries operating?
 - b. What other means are available for sale of butterfat?
 1. Local commercial creameries.
 2. Cream stations.
 3. Direct shipment.
- 3. Facilities.**
 - a. Can satisfactory facilities be leased for a time?
 - b. If so, on what terms?
 - c. If facilities cannot be leased, estimate cost of building and equipment needed.
- 4. Plan of financing operations.**
 - a. What capital is needed and for what purposes? (organization, buildings, equipment, other investments, operating capital).
 - b. How is necessary capital to be raised?
 - c. How much can be secured from producers? (in cash, as notes).
 - d. How much can be secured from local business men and other nonproducers through sale of preferred stock or other securities?
 - e. What is attitude of local banks toward giving assistance to association?
- 5. Operations.**
 - a. Attitude of members regarding pooling of products.
 - b. Will members require payment in full at the time they deliver cream or will they be satisfied with a small advance payment?
- 6. Quality.**
 - a. Is cream paid for according to quality?
 1. Differences in price between No. 1 and No. 2 cream.
 2. Can cream be paid for on the basis of its quality?
 3. Estimate probable amounts of No. 1 and No. 2 cream.
- 7. Market.**
 - a. Where will the various products be sold?
 - b. Can local market be developed for butter, cheese, and other products?
 - c. Can the association advantageously join a cooperative sales agency?
 - d. What are transportation costs to terminal markets?
 - e. What grade of product can be produced?
- 8. Estimated price that could be paid for butterfat.**
 - a. Average price, on Chicago and New York markets, of butter of grade to be manufactured, cents.
 - b. Add 23 per cent overrun to New York or Chicago price, cents.
 - c. Chicago or New York price plus 23 per cent gives butterfat price, cents.
 - d. Deductions:
 1. All association's costs of operating reduced to a cost per pound basis, cents.
 2. Add 23 per cent to get butterfat cost, cents.
 3. Freight per pound of butterfat, cents.
 4. Add for reserves, cents.Total costs, cents.
 - e. Estimated price which can be paid for butterfat, $c - d$, cents.

ASSOCIATIONS HANDLING FLUID MILK

Prepare a map of territory showing where fluid milk is produced for market.

- 1. Present market for milk.**
 - a. How many distributors are in the market?
 - b. What is—

1. Total quantity milk purchased by each?
2. Total sales of each?
3. Surplus carried by each?
4. Price paid for fluid milk?
5. Price paid for surplus milk?
6. Is price quoted f.o.b. city or at farm?
7. Number producers shipping to each?
2. Is there a basic rating plan used in the market?
 - a. Do all dealers use same plan?
 - b. What are base months?
 - c. Comparisons of plans used by each dealer.
3. Is raw milk sold in city?
 - a. Number raw-milk distributors.
 - b. Quantity of milk sold.
 - c. Price.
 - d. How is surplus raw milk disposed of?
 - e. What inspection is made of raw milk?
 - f. Percentage of total sold as raw milk.
4. From above data compile—
 - a. Total daily production of milk available.
 - b. Total daily sales of distributors.
 - c. Total daily surplus of milk.
 - d. Percentage.
 - e. Compare these for periods of low and high production.
5. Sales price of milk.
 - a. Price of retail milk (family delivered).
 - b. Price of wholesale milk.
 - c. Price of milk sold from stores.
 - d. Percentage of total sold at wholesale.
6. Disposition of surplus milk.
 - a. Quantity manufactured in country.
 - b. Quantity hauled to city and manufactured.
 - c. Products manufactured.
 - d. Can surplus be held in country for manufacture?
 - e. Compare quantity surplus summer and winter.
 - f. List distributors with surplus manufacturing equipment.
7. Prices paid producers in other sections.
 - a. Price paid producers for milk in other near-by cities.
 - b. Prices paid for sour cream, sweet cream, condensed milk, or for other products in territory.
8. Transportation.
 - a. Cost of hauling from various sections of milk shed.
 - b. Do routes supplying various distributors overlap?
 - c. Are hauling rates high because of this duplication?
 - d. Survey the possibility of consolidating routes and effecting savings through the use of fewer trucks with larger loads.

The Problem of Membership.—Since a cooperative association is owned and controlled by its members, who are also its patrons, the determination of the qualifications, rights, responsibilities, and conditions of membership is an important matter. The success of any

cooperative venture is limited by the degree of support and loyalty given by the members. The management, on the other hand, must secure and maintain the confidence of the individual members. Practically all associations limit membership to producers and to those who would be benefited by belonging and would, at the same time, be an asset to the association. The volume of business transacted affects costs and thereby savings and prices; consequently, each cooperative wants as large a percentage of the eligible members as possible.

The democratic ideals of cooperation are maintained by limiting each member to one vote. When an association is organized on a stock basis, the control is prevented from getting into the hands of one or a few individuals by limiting the number of shares one member can hold. The important point is that control should remain in the hands of those for whose benefit the organization was formed.¹ This control is usually exercised through a board of directors which is directly responsible to the members.

Securing Cooperation through a Contract.—Some cooperatives use an ironclad long-term contract to bind the members to specific performance. Other associations have been highly successful without this feature, while a number have failed in spite of it. This situation has caused a great deal of discussion as to the merits and the demerits of the so-called ironclad contract.² The contract idea was probably borrowed from Danish practice. That the contract fails to secure specific performance on some occasions is attested to by the fact that in 1925 some 20,000 members of the cotton cooperatives are reported to have failed to do as they had agreed. It was obviously impracticable to take all these cases to court. Judgment, no doubt, would have been secured eventually against practically all, but the costs would probably have exceeded the receipts. Many farmers were not financially able to pay the judgments. The contract, nevertheless, may serve a useful purpose, since it does tend to force some weak-willed members to support the organization under temporarily adverse conditions and encourages them to refuse the bait thrown out by competitors, vested interests, and others who for various reasons wish to see the cooperatives eliminated. It cannot, however, insure specific performance when unsatisfactory conditions result from chronic poor management, ill-advised policies, faulty organization, and careless methods.

The long-term contract tends to scare conservative farmers away. They may feel that the cooperative idea offers great possibilities, yet

¹ It has been claimed that the centralized association furnishes control by experts, while the local and federated groups are on a democratic basis with non-expert management. It is obvious that there is nothing to prevent the federated groups from hiring expert managers.

² Consult Filley, *op. cit.*, pp. 405 ff., for a summary of the pros and cons.

know that in practice the plan may fail due to a number of causes; consequently, they hesitate, unless driven to it as a last resort, to bind themselves for a period of years.¹ The happy compromise seems to be the long-term contract with a withdrawal clause. Thus the contract may run for a period of five years, but during a certain definite short period each year a member may be permitted to withdraw upon giving adequate notice. If the cooperative gives the members real service and succeeds in convincing them that it is doing so, and will continue the good work, there will be few withdrawals. The probabilities are that an appreciable increase in membership will be secured.

Some Legal Aspects of the Contracts.—The legality of the standard contract has been tested in a number of courts. It is a contract of *purchase and sale* of personal property, and not a case of agency. The courts have apparently definitely decided that the contract cannot be evaded by subterfuge, such as giving the crop to a relative, or leasing the land to a tenant on a share basis; if, on the other hand, the land is leased on a cash basis, in good faith, the signer is released, since he ceases to produce either directly or indirectly. A contract is invalid if obtained by threats or through misrepresentation. A mortgagee has prior claim to the contracted crop if he did not know, at the time of taking the mortgage, of the association contract; otherwise the association has prior lien. The contract is valid against a landlord's lien. The association has a right of action for recovery of damages against a third party who causes a member to violate his contract.²

Control of Quantity and Quality of Production.—Some of the associations, especially those in the dairy, fruit, and grain fields, have been fairly successful in bringing about an improvement in the quality of the product. The fluid-milk associations were quite successful for a while in exercising a fair degree of control over the volume of production. This control can hardly be established, as a long-run proposition, by merely appealing to the loyalty and patriotism of the members. Some form of suitable incentive that will reward the producer for increasing quality and increasing or decreasing production, as conditions may warrant, should be devised.

The producers are encouraged to improve the quality of their products when the premium which the market is willing to pay for quality merchandise is passed on to them. The cooperative associations have done much to establish and maintain definite standards of quality. Their systems of grading and inspecting accurately and impartially classify

¹ These contracts may run from three to twenty years. Some of the state laws place a limit of ten years.

² "Legal Phases of Cooperative Associations," U.S. Department of Agriculture, Bull. 1106.

each grower's output. Each member is then paid on the basis of the volume of each grade he delivers. The man with a high percentage of first-class goods obviously should receive a better return than his neighbor who delivers a large percentage of low-grade goods. The success of some of the cooperatives handling eggs, milk, butter, cheese, oranges, raisins, prunes, apples, grain, and cotton indicates the advantages of properly rewarding quality production.

The control of output or the stabilization of supply is more difficult. The uncertain element of the weather makes satisfactory control of production for many crops impossible. There is a possibility of the control of planting, breeding, feeding, packing, canning, and the like, if suitable incentives are offered. The plan of the A.A.A. secured substantial reductions in the acreage of wheat and cotton, and in the number of hogs.

The fluid-milk associations have worked out an interesting plan for controlling the production by their members. They follow what is called the rating or basic surplus plan for stabilizing production throughout the year. The incentives to the producer are given in the following manner: A producer is paid a given price, based on fluid-milk market conditions, for an amount of milk equal to his average fall production during October, November, and December, for the following nine months. If he exceeds this average figure, he receives for the excess amount a lower price, based upon the price of butter and the size of his surplus. Increased production, due to the admission of new members, is controlled by not granting them terms as favorable as those enjoyed by the old members.

This plan obviously has limited application.¹ The characteristics of fluid milk and the methods of production and of marketing fit in with this plan. The product is highly perishable, and must be marketed immediately; the market is highly localized and concentrated; the demand is quite regular throughout the year; and the producers are usually located in a relatively small area surrounding the point of concentrated consumption. The situation is quite different with milk, which flows continuously from daily production to daily consumption, than for an annually produced crop, such as grain and cotton.

Financing the Cooperative Activities.—The amount of funds required by a cooperative association depends upon the commodity handled, the method of marketing used, and the extensiveness of the services furnished by the organization. The financial needs of a local live-stock shipping association, which merely assembles the members' live stock,

¹ The two-price system broke down during 1932-1934 due to the efforts of farmers to maintain dollar volume with falling demand and prices. The result was an over-supply of milk and lower prices for butter and other manufactured dairy products.

ships the animals to market, and distributes the net proceeds upon receipt from the buyer, are small compared with the needs of a large centralized association that finances the producer during the growing season, makes substantial advances on delivery of the product, provides processing, warehousing, grading, packing, and other handling facilities, and maintains an extensive marketing organization. The capital requirements, according to an official estimate, for a milk association that owns its plants and operates fifteen to twenty retail routes in a small city are from \$9 to \$10 per quart of business done daily. The typical cotton, grain, dairy, and fruit associations may require millions of dollars of capital.

Sources of Funds and Credits.—The funds needed by a cooperative association may be secured from a number of sources by different methods. Some of the more commonly utilized sources and methods are mentioned at this point. When only a small amount of capital is needed, a small membership fee may be sufficient. Annual dues have been tried, but the difficulty and expense of collecting them make this plan unpopular. The revolving fund or the certificate of indebtedness plan¹ is widely used. Under this plan a definite amount is deducted from the net returns of each member and a certificate of indebtedness is issued to him.¹ The Apple Growers' Association of Oregon deducts a certain amount per box for the capital fund investment. Each grower member has a share in this fund in proportion to his contribution. This plan is slow, as it may take an association five years to secure the amount of capital necessary to operate the business efficiently. Some associations make a service charge based on the number of physical units handled or on the value of the product sold for each member. Some of the bargaining fluid-milk associations have agreements with the distributors to deduct or "check-off" this charge before making the payment to the producer. A few associations charge commissions; others retain a portion of the savings—*i.e.*, they do not give to the members in the form of patronage dividends the full amount of the savings. The amount secured from this source, however, is limited if the association is operated conservatively. The cooperatives are not in business to make or show a profit but to make savings and pass these on to the members, usually in the form of higher net prices for goods sold and lower prices for merchandise bought.

The large associations have to resort, in the main, to borrowing and to the sale of securities of their subsidiaries to raise the large sums necessary. Funds are borrowed from members, banks, governments, and the public. Bonds, notes, and warehouse receipts are used as the principal credit instruments.

¹ Some associations issue interest-bearing certificates; a few pay no interest. The majority provide for the redemption at a definite future date, usually five years; a few make no promise of redemption, but follow this practice if their finances permit.

The Texas Farm Bureau Cotton Association has a 1 per cent reserve fund which provides for its own expenses and enables it to control its subsidiary corporations—the Finance Corporation, the Sales Corporation, and the Gin Corporation—through the ownership of their common stock. It secures a large portion of its working capital for the purchase of cotton through a special arrangement with an eastern banking syndicate. Sixty- to ninety-day sight drafts with warehouse receipts attached are drawn upon and accepted by members of the syndicate. These acceptances are then eligible for rediscount or may be purchased in the open market by the federal reserve banks. The amount that the syndicate will loan is determined by the price of cotton.

The amount of funds needed by an association varies according to a number of factors. In the case of cotton, for instance, the amount necessary to make the customary advances when the cotton is delivered to the association depends upon the amount of cotton received and the rate of delivery, the proportion of the current price allowed,¹ and the time and rate of selling the cotton by the association. If the cotton moves rapidly through the hands of the association into the possession of the manufacturers, a smaller amount of capital is necessary than when the cotton is stored and held for higher prices.

Sound financing requires, in addition to the provision of ample working and fixed capital, that sufficient reserves be set up and maintained. Adequate reserves for losses from bad debts, depreciation, obsolescence, and for contingencies are maintained by the progressive organizations.

Financing Since 1933.—The severe depression of the 1930's clearly demonstrated the limitations of the cooperatives. Since they could not raise and maintain prices, restrict production, and solve the farm financial problems, the cooperative movement lost some of its prestige. The interest of the government, the farmers, and the public turned to the activities of the A.A.A. and the Farm Credit Administration. The former gave its attention chiefly to the problem of the surpluses, and the latter to the financial problems. We have discussed the operation

¹ The amount usually advanced is 60 to 80 per cent of the current price, the exact percentage being governed by market conditions. The Farm Board, however, during the summer of 1930 authorized the cotton association to advance as much as 90 per cent of the current market price. The source of this increased credit was the \$500,000,000 revolving fund provided by Congress in the Agricultural Marketing Act of 1929. The A.A.A. loaned 10 cents a pound when the price was 10 cents, and 12 cents a pound when the natural price would have been less than 12 cents. On Aug. 23, 1935, when it appeared that the loan for the 1935 crop would be reduced to 9 cents a pound the market for cotton fell about \$4.00 a bale for a few hours during the day. This action tended to confirm the contention that the government loan of 12 cents created an artificial price for cotton. The A.A.A. raised the loan to 10 cents and virtually guaranteed the farmers 12 cents a pound.

of the A.A.A. in preceding chapters. Since the F.C.A. was designed along cooperative lines, we shall briefly describe its organization and activities.

The purpose of the Farm Credit Administration is to promote the organization of "cooperative credit units to make available low-cost credit of financial centers." Chart XVII indicates how farmers and

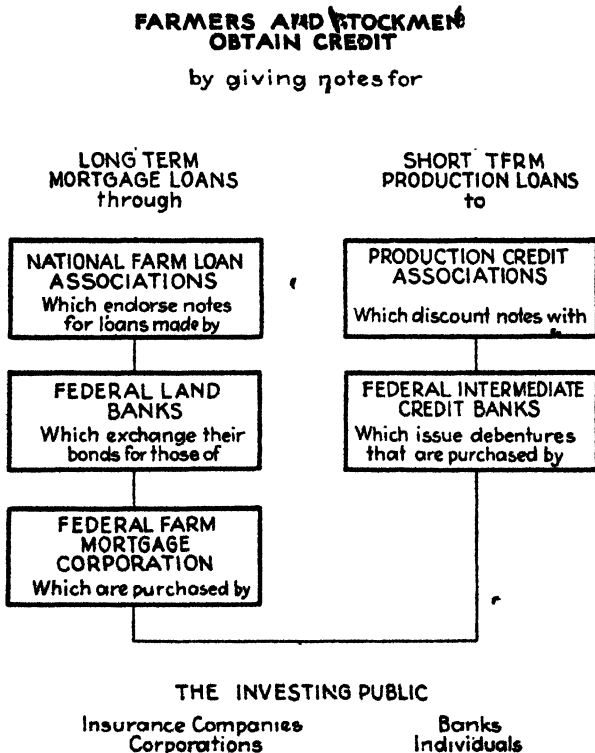


CHART XVII.—Credit cooperatives. (From a statement of the F.C.A.)

stockmen may obtain either long-term or short-term credit by making application through the national farm loan associations or to the production credit associations. The national farm loan associations endorse the notes for loans which are made by the federal land banks. These banks exchange their bonds for those of the Federal Farm Mortgage Corporation. These securities are then sold to the investing public. The public is protected by having the securities guaranteed by the federal treasury. The production credit associations discount the notes with the federal intermediate banks which issue debentures that are purchased by the investing public.

During the first two years of its existence the F.C.A. loaned almost \$3,000,000,000. The cooperative farm financing system which was already in existence was supplemented by the formation of the production credit administration and the banks for cooperatives; all were combined under one management designated the Farm Credit Administration. Total long-term credit loans equaled \$1,728,000,000, short-term production credit loans reached \$955,000,000, and loans to farmers' marketing and purchasing coopeatives amounted to \$241,000,000 for the first two years.¹

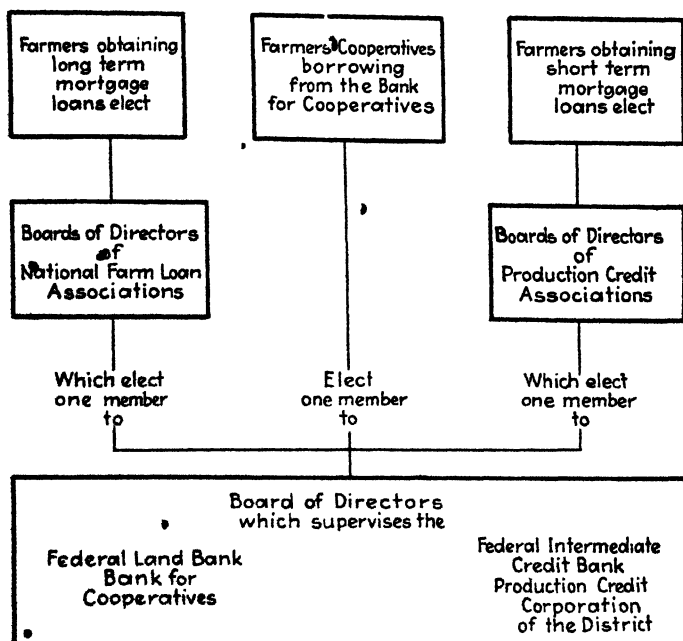


CHART XVIII.—The farmer and the control of the cooperative credit institutions. (From a statement of the F.C.A.)

Chart XVIII indicates the cooperative nature of the control of these farm credit agencies.

The board of directors of the national farm loan association, which is elected by the farmers, elects one member to the board of directors which supervises the federal land banks, banks for cooperatives, federal intermediate credit banks, and the production credit corporation of the district. The farmers' cooperatives, through the bank for cooperatives, elect one member of the general board, and the board of directors of the production credit association elect one member. There are seven mem-

¹ From a Press Release of the F.C.A. dated May 24, 1935.

bers of the board, so the federal government maintains control for the present. This is due to the fact that it has put into the banks millions of dollars of public money and has guaranteed some of the bonds as to principal and interest. These financial agencies are to be ultimately under farmer cooperative control. They were designed to meet a need that was not adequately met under the conditions that arose during the depression.

The duration of the loan is longer and the rate of interest lower under the new arrangement than was previously the case. The farmer can now repay his loan on an installment plan extending over a period of more than thirty years. The idea is to furnish farmers with long-term, short-term, and group credit at cost. Eventually, it is hoped, the farmers will own all the stock in the various farm credit agencies and be able to exercise in an intelligent manner the duties and responsibilities of ownership.

The Returns to the Members of the Farm Cooperatives.—The stock companies make some returns to their members in the form of dividends. The rate of dividend payment is now usually limited by state law. The maximum in almost all instances is 8 per cent. Since these associations are not organized for profit, but to bring about savings through more effective marketing and through group sharing of risks, two major forms of making returns to members are used. These are through *pooling* and by means of the so-called *patronage dividend*.

Pooling.—Pooling is a method of apportioning risk through averaging with respect to products, prices, expenses, and returns. The pool typically comprises the output from a limited area. When each pool is limited to one grade and variety of commodity, better results are secured. Thus the goods are carefully graded as they are delivered by the members, and all products of the same grade are put into one pool. Upon sale of the pooled products each member receives his pro rata share for each grade. If the pool is organized on a seasonal basis, each member receives an amount equal to the average price received during the season for each grade, times the amount he had in each grade. The price used is determined by subtracting the expenses of marketing and other authorized deductions from the gross receipts, and then dividing this remainder by the total number of units sold.¹

There are daily, semiweekly, weekly, monthly, and seasonal pools. The character of the product, methods of production and of marketing, price outlook, and a number of other factors should be considered in establishing a particular form of pool.

¹ The unit used depends upon the kind of product. Cotton, for example, is usually sold by the bale, grain by the bushel, and dairy products by the pound; fruits may be sold by the box, barrel, and car.

The pooling method is not advisable for all products and all conditions of marketing, and is not an essential feature of cooperative activity. The monthly pool works well, apparently, with milk-producers' associations. The annual pool has proved satisfactory when used by some of the fruit growers, but unsatisfactory with the wheat and potato growers. The short-term pool seems to be favored by the cotton associations.

Some Defects of the Plan.—Since every member of each pool receives exactly the same price, the opportunity for speculation for a rise in price is taken away. The practice does not permit the man with superior ability and facilities who produces a better grade than the *average*, to enjoy the premium in price that is justly his. The effect of the pool is to raise the price for those whose products just barely meet the standard of the grade, and to lower the price for those whose products are at the top of the grade.

Sometimes a pool comprising inferior grades sells for a higher price than a pool of superior grade sold at another date during the season, or at about the same time but in a different market. The dissatisfaction resulting from this situation has led to the use of a plan that is more satisfactory in some respects. The commodity is carefully graded and sold by grades throughout the season. The entire output, however, is sold in one pool. The price is distributed according to grade, a proper differential for each grade being provided. The individual grower then gets a "base" price with so much "on" or "off" the base price, depending upon the classification of his product. Thus prices and returns are apportioned according to the quality of product delivered. This plan does not solve one objection. The producer who delivers all his output at one time when prices are higher than the average for the season does not get the full benefit of this higher price. The grower who delivers his entire crop at a time when prices are below the seasonal average benefits.*

The pool in so far as it succeeds in distributing risks is probably of distinct benefit to the great majority of members. The successful management of a pool, however, is a difficult task and should be placed only in the hands of experts.

The Patronage Dividend.—The so-called patronage dividend is a device for returning to the members the *savings* effected by the cooperative associations. Those organizations that pay the full market price for the products at the time of delivery usually figure their cost of operation on a fixed schedule. No patronage dividend can be distributed when members are paid the *net proceeds* at one time. The fact that an association usually does not know and cannot predetermine its actual expenses makes it desirable to play safe and keep back ample funds to cover these charges. At the end of the year, or at some other designated

period all expense charges and deductions are subtracted from the amount kept back for expenses. The amount remaining is then distributed among the members on the basis of the volume or the money value of the product handled. The following quotation indicates the method used to determine the amount of the return.¹

The amount of the patronage dividends to which a member is entitled is ascertained, by some associations, in substantially the following manner: The total amount available for distribution among the member patrons at the end of the year or other period is determined. This amount is then divided by the volume of business handled by the association in terms, for instance, of cars, bushels, pounds, head, or the value of the product handled in dollars, or the amount paid to the association as handling charges. The figure thus found, when multiplied by the number of cars, for example, handled for a given member, gives the amount of his patronage dividends. In other associations the patronage dividends are ascertained by dividing the total amount available for distribution by the total sale price of the products handled and then multiplying the price received for the products of each member by this percentage.

Factors That Determine Success and Failure.—While the number of factors that might cause failure and of those that lead to success is legion, experience has demonstrated that there are some that appear again and again. The causes of failure may be grouped under two major headings: *internal* defects and *external* opposition.

One of the major internal defects is lack of appreciation of the complexity of the marketing problems. Members expect too much—even the impossible and unreasonable—and when these expectations are unrealized, disloyalty develops. Other internal defects are lack of capable, earnest, and honest leadership; mismanagement, extravagance, and secrecy about the affairs of the association on the part of the officers; the feeling of freedom and independence on the part of members—they do not want some one else to tell them what, when, and how “to run their own business”; unwillingness to make present sacrifices for future gains; attempting to form an organization comprising members with diverse interests; admitting members who cannot or will not live up to their responsibilities. Members must be willing to spend time, money, and energy for the good of the group, and be farsighted enough to remain loyal when competitors offer special inducements for the purpose of breaking up the association.

Opposition from outside interests may be a strong contributing factor to the failure of an association. This opposition is likely to come from those whose business may be adversely affected by the success of the movement. Manufacturers may fear that they will have to pay more for their raw materials, lose control over the source of supply, or, in

¹ HULBERT, L. S., *U.S. Department of Agriculture, Bull.* 1106, p. 103.

the case of a cooperative purchasing association, lose business or have to sell at lower prices. Certain middlemen—retailers, wholesalers, and brokers—who run the risk of being displaced may offer opposition. Service corporations, such as transportation companies, banks, warehousing firms, and others, have placed many obstacles in the way of the cooperatives either because they feared that their own business would be injured or because they wished to help some business that was being or might be adversely affected.

The Tobacco Growers' Cooperative Association, for example, was opposed by the large tobacco manufacturers who refused to buy from the association. It was opposed by the leaf dealers, warehousemen, buyers for the large companies, merchants, bankers, and other business men in some of the larger and more important markets. Some of the methods used to break down the association were: paying high prices for split-crop tobacco; predicting the failure of the association; spreading propaganda in regard to salaries paid, extravagance of the officials, honesty and integrity of the management; and using as propaganda every misstep of the association. Many of the bankers and time merchants helped to prevent delivery to the cooperative by encouraging or forcing members to break their contracts.¹

The cooperative grain elevator associations met opposition and unfair methods from a number of sources. Merchants refused to buy from or sell to them. The large line elevator firms would outbid the local cooperative for the farmers' grain until they broke up the association. The railroads refused sites for the farmers' elevators and would not give them cars so they could ship their grain, but allowed the line companies all the transportation facilities they wanted, and granted rebates on freight to the competitors of the cooperative elevators. The members of the organized exchanges and terminal elevator firms strenuously opposed the movement. Many of these practices were not stopped until the agricultural interests were able to get state and federal laws enacted that forced railroads to sell elevator sites to the cooperatives, assign cars with impartiality, and to cease granting rebates.²

Requisites for Success.—The experiences of cooperatives in both the United States and foreign countries reveal a number of conditions and attitudes necessary for success. The following summary gives some of the more important ones. There must be a real desire on the part of the farmers for group action. The members should have a definite knowledge of the disadvantages as well as the advantages of cooperatives.

¹ SCANLAN, J. J., *U.S. Department of Agriculture, Circ. 100*, pp. 118 ff.

² Such practices as those enumerated are partially responsible for the laws creating the Interstate Commerce Commission and the Federal Trade Commission, and for the Packers and Stockyards Act and the Capper-Volstead Act.

The character of the product, method of production, and the mental attitude of the producers must be suited to the cooperative method. Members should be solicited in a businesslike manner with no high-pressure or brass-band methods of persuasion. Success depends upon obtaining an efficient management that can secure and maintain the confidence and support of the members, and that can develop an organization for doing the office work in an effective manner; that can determine when, and under what conditions, direct marketing to industries, merchants, and terminal markets is advisable; that can organize and operate pools when such practice is advisable; that can bring about the elimination of wastes through grading, standardization, and packing; and that can secure low overhead costs through large-scale volume. A management that is alert to the opportunities for promoting the best interests of the association, through legislative acts and other means—with transportation companies, storage firms, organized exchanges, financial and other institutions and agencies that are in a position to affect the degree of success attainable by the association—is essential. A public-relations policy that keeps members loyal, the consumer satisfied, and the trade friendly is indispensable to permanent success.

Cooperation among Cooperative Associations.—The Federal Farm Board promoted the formation of large central selling agencies organized on a commodity basis. The grain growers, cotton planters, producers of wool, bean farmers, cheese and milk producers, and live-stock raisers were the first agricultural groups to form the centralized marketing agencies under the sponsorship of the board. These marketing organizations, it was believed, would have increased bargaining power. They could improve, it was contended, marketing methods by introducing more effective grading and packing; they could, where feasible, brand and advertise the product on a large scale; they would be able to bring about more satisfactory transportation services, establish and maintain sales representatives in the more important central, terminal, and foreign markets; they could establish central warehouses, elevators, and cold-storage plants; and secure honest and fair treatment for their members from independent agents, merchants, manufacturers, bankers, transportation companies, and storage firms. These large cooperatives, working back through their district and local members, would be able to adjust the quality of the product and the volume of production more accurately to market demand and conditions. The giant associations, because of their widespread connections and facilities for collecting and interpreting market information, are in a position to determine, with a fair degree of dependability, the true market value of the product, and to forecast general business conditions, the volume of production, inventories, demand, and prices.

The original purpose of the national sales agencies is expressed in the following quotation.¹

We believe that the ultimate goal of farm organization is to organize by commodities, first, into local, then into regions, and then into national sales agencies. Seven of these national sales agencies have been organized with the assistance of the Board and are now functioning as follows: The Farmers' National Grain Corporation, with 27 grain cooperatives as member units; The American Cotton Cooperative Association, with 11 cooperative cotton associations as member units;² The National Wool Marketing Corporation, handling, its first year, approximately 35 per cent of the wool clip of the country and 95 per cent of the mohair; The National Livestock Marketing Association, with 20 units, handling approximately 58 per cent of the livestock sold cooperatively in the country; The National Pecan Association, with 20 units; and a national sales agency for sugar beets and one for beans.

Some of the objects of these national sales agencies are to regulate the flow of the commodity to market in an orderly way, to furnish the grower with accurate market information, to assist in regulating production to demand, to improve quality and encourage the production of the character of the commodity most in demand, to concentrate the bargaining power of the individual into the hands of his own sales agency, which tends to place him on a parity with the buyer, and to develop adequate and sufficient credit facilities at reasonable interest rates for members, in sections where needed.

The Organization of the Giant Associations.—The grain growers were among the first to organize a centralized marketing association, called the Farmers' National Grain Corporation. The incentive offered the associations for meeting the standards set was the financial and other forms of assistance available. Upon formation of the grain association, the federal government made available \$160,000,000 to wheat farmers belonging to approved cooperatives. This was to enable the members to hold their grain from the market during the period of low prices.

These large-scale central corporations are stock companies incorporated under the laws of Delaware. The general manager of each organization must be an experienced business man, not necessarily a farmer. The various departments of the association, such as educational, research, marketing, and clerical, are established and operated under his direction.

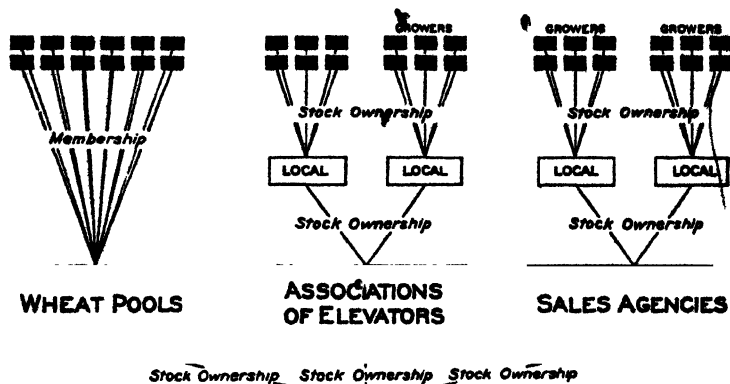
The membership of the central association is made up of cooperative associations that buy the stock. The kinds of associations that belong to the Farmers' National Grain Corporation are farmers' elevator associations, farmer-owned grain sales agencies, and growers' grain pools.

¹ By Mr. Stone, chairman, *Federal Farm Board*, News Release, Mar. 9, 1931.

² Mr. Stone stated in a radio speech, Mar. 14, 1931, that during 1930 the Farmers' National Grain Corporation sold more than 100,000,000 bushels of grain for its 27 members, and that the American Cotton Cooperative Association with 11 state and regional members handled more than 2,000,000 bales.

Chart XIX illustrates the organization setup of the corporation. Each individual cooperative retains its former members, gathers the grain for delivery as ordered by the grain corporation, and remits the payments to members.

The territory within which the corporation operates is divided into five districts. Directors from any district are nominated by the type of association which they represent, and hold office for three years. Provi-



FARMERS NATIONAL GRAIN CORPORATION

CHART XIX.—National Grain Corporation.

The Farmers' National Grain Corporation is owned and controlled by growers under a centralized plan charted above. Growers participate in the control of the National either by taking out membership in a wheat pool or by buying stock in a local elevator association, which in turn owns stock in a large-scale cooperative. In some cases growers may buy stock direct in a sales agency.

The corporation's stockholders are divided into wheat pools, elevator associations, and sales agencies. The farmer's grain is delivered to the local associations or pools, and it is sold under the triple-option plan controlled by the National. (*Federal Farm Board Bull.* 3, p. 9.)

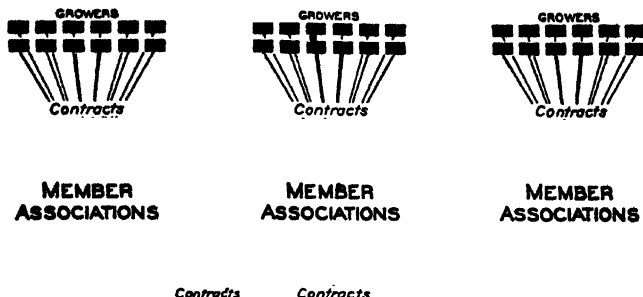
sion is made for reapportionment of directors from time to time. This plan is to keep the management representative of those who make use of the facilities and to safeguard the control.

The grain corporation started with an authorized capital of \$10,000,000 and the provision that no patronage dividends should be distributed until the capital and surplus reached a total of \$20,000,000. The rate of dividend on all capital stock is limited to 8 per cent. The stock was subscribed to by the eligible associations on a minimum basis of \$100 for each 2,000 bushels of grain handled by the applicant.

The national corporation may buy grain outright, perform the services of a broker, serve as a contact agency with the Department of Agriculture, and operate in the terminal and export markets. If and when proper

support is given by the locals, and if the membership of the locals comprises a large proportion of the producers, some degree of success in the control of acreage and of an ordinary surplus can be attained.

The corporation purchased Quinn-Shepardson Co. of St. Paul, a big commission house, which gave the organization agencies in Minneapolis, Duluth, and Great Falls. It is equipped to sell wheat in the foreign market as well as in the domestic. One lot of wheat, for example, was delivered "directly from farmers of the Southwest to the door of a cooperative consumers' society mill in Scotland, a direct sale from



AMERICAN COTTON COOPERATIVE ASSOCIATION

CHART XX.—American Cotton Cooperative Association.

The above chart shows the organization set-up of the American Cotton Cooperative Association at New Orleans and indicates how more than 150,000 member farmers own and control this central sales agency. It also shows how the growers, who are members of the 11 state and regional associations, are affiliated by contracts through member organizations with the American association. The central agency is primarily a merchandising organization. The chief functions of the member agencies are to receive cotton, keep the records, and form the necessary contacts with their members. (*Federal Farm Board Bull.* 3, p. 15, December, 1930.)

producer to consumer without any other agency intervening. Thus three or four profit-taking agencies were eliminated."¹

The American Cotton Cooperative Association.—Chart XX illustrates the organization of the cotton cooperatives. These associations handled 17.1 per cent of the total crop in 1930. The following quotation indicates the purpose that motivated the organization of the central association:²

¹ Statement attributed to C. E. Huff, quoted from *The Business Week*, p. 6, Aug. 6, 1930.

² Carl Williams, in an address prepared for delivery before the National Association of Cotton Manufacturers, Boston, May 1, 1930, *Commerce and Finance*, No. 19, pp. 951 ff., May 7, 1930. The American Cotton Cooperative Association is the official name of the centralized marketing organization.

So far as permanent policies are concerned, it is inevitable that the cooperatives shall be cotton merchants, operating on the cotton markets of the world as cotton merchants do and meeting the needs of the mills and the textile trade on a basis of real service. It is inevitable, also, that regardless of the permanent success of the cotton cooperative movement, a large part of the American cotton crop will always remain to be handled by private merchants. The fundamental attitude of the cooperatives themselves toward these merchants is an essentially friendly one and, in my opinion, following the readjustment period through which the cooperatives are now passing, that friendliness will develop working methods that are pleasing to both.

The job of the Federal Farm Board, however, is infinitely larger than that of attempting to meet emergency situations or even that of encouraging the organization of farmers into strong, self-controlled and self-financed marketing institutions. Under the Agricultural Marketing Act the Federal Farm Board is essentially an agricultural planning board. It must look ahead as best it can. It must keep abreast of production and consumption in all nations. It must pass its information along to the farmers of America so that they may not only intelligently market their crops, but, and more important, so that they may produce the qualities and quantities of crops that are demanded by the consumers of the world.

One specific Farm Board project, for instance, is the improvement in the character and staple of American cotton. We recognize the relative deterioration of recent years. We recognize the excess costs of production in some parts of the belt. We know that on the average the man who produces less than one-third of a bale of lint to the acre does so at a loss. We know that the South does not feed itself and that more acres planted to food and feed are essential to financial independence. We recognize no difference between a profit gained by an increased price and a profit gained by a lowered production cost, except that the latter method of gaining a profit is better for the land and causes less labor for the man than the former. We recognize that one of the most serious handicaps to cotton farmers and to the cotton South is the annual fluctuation in the acre income of the cotton farmer. How is it possible for a farmer to be permanently prosperous when the value of lint cotton in 1920 was but 46 per cent of that in 1919, or when its value in 1922 was 180 per cent of that in 1921, or when the value of lint cotton in 1926 was but 65 per cent of its value in 1925? A widely fluctuating price for cotton has done much economic harm to the cotton South. The need of the cotton farmer is a stable price at a fair level which will return a profit to the efficient farmer.

I venture to suggest that the need for this stable price is just as great on the part of the textile manufacturer as it is on the part of the cotton farmer. It can never be achieved except by farmers themselves with the aid of government.

The Farm Board knows that the Agricultural Marketing Act did not repeal the law of supply and demand. Farmers must still merchandise their crop on a basis of what the world is willing to pay for the amount produced. Nevertheless, farmers can iron out some of the peaks and valleys in the price level and get for themselves a more certain and dependable income by collectively having something to say as to the time and place of sale and the quality and quantity offered

at that time and place. That is their purpose, and it is one of the purposes of the Federal Farm Board.

It is possible that developments of this character, while aiding the farmer to eliminate his own annual gamble on production income, will at the same time aid the spinner to eliminate his annual gamble on his raw material and his consequent gamble on his finished product. It seems to me that there is a very great mutuality of interest between producers and spinners. The farmer knows that the mills are his necessary customers. The mill knows that the farmers are its necessary producers. It has always been hard for the mill man and the farmer to meet on common ground or to understand one another's problems. This thing now becomes easier. Farmers are organized and so are the mills. The leaders of these groups not only may but should constantly confer one with another so that the best interests of both will be served.

National Live-stock Marketing Association.—After considerable discussion and delay, the National Live-stock Marketing Association was formed during 1930. This live-stock cooperative organization attempts to coordinate and control sales, keep member sales agencies fully informed by daily reports of market conditions, and provide ample credit facilities. This association, in common with the others of similar kind, was organized under the laws of Delaware, and is owned and controlled by various regional cooperative live-stock associations. Most of these constituent organizations are cooperative selling agencies which sell live stock on terminal markets. Because of the strong feeling of individualism among live-stock producers, not all of the cooperatives existing at the time joined the national association.

It is estimated that cooperative associations handle about 18 per cent of the live stock received in the central markets; the associations that joined the national organization had been handling slightly more than half this amount, or approximately 10 per cent of the total receipts.¹ There is at least one cooperative commission association in each important live-stock market between Buffalo and Pittsburgh on the east, and Denver and Wichita on the west. They handle stock shipped from cooperative shipping associations and, in addition, a large quantity from other sources. They are in most instances the largest organization on their respective markets. The largest commission house in the world is the Central Cooperative Commission Association which operates on the St. Paul market.

The membership of the National Live-stock Marketing Association comprises twelve cooperatives which had been formed by the National Live-stock Producers' Association, an organization fostered by the American Farm Bureau Federation, and three associations that had

¹ From an article by Herman Steen, "Centralized Control Wins," published in *Successful Farming*, pp. 11, 44, July, 1930.

been engaged in selling direct to the packers without going through a terminal market. These three are: the Western Cattleman's Association, the Texas Live-stock Marketing Association, and the National Order Buying Company. Chart XXI visualizes the organization of the National Live-stock Marketing Association, and indicates the relationship existing among the constituent elements. The Farmers' Union group and four independents refused to join.¹

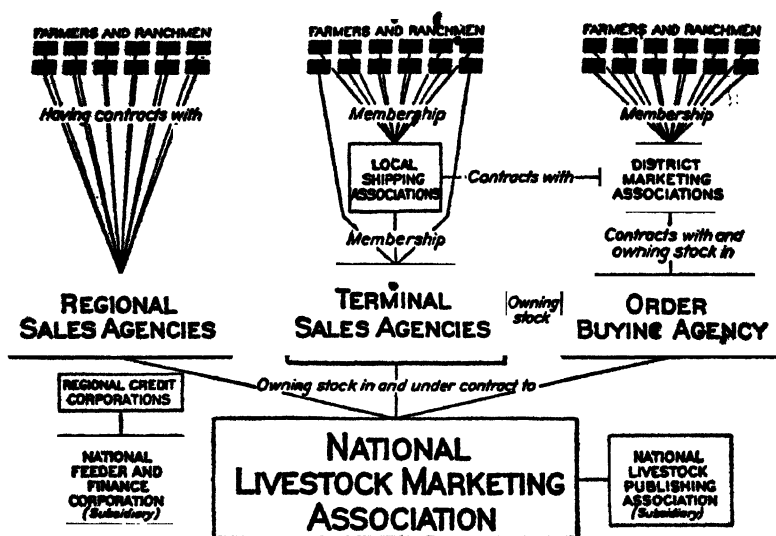


CHART XXI.—National Livestock Marketing Association.

Farmers and ranchmen have several ways of marketing their live stock cooperatively through the various agencies affiliated with the National Live-stock Marketing Association, as indicated on the above chart.

They may ship to cooperative regional or terminal agencies, or local, county, or district associations.

The three different types of sales agencies—terminal, regional, and order buying—own stock in and are under contract to the National Live-stock Marketing Association. (*Federal Farm Board Bull.* 3, p. 21.)

The following quotation from Mr. Steen's article² indicates the powers of the National Live-stock Marketing Association and also states why some cooperatives refused to join.

The new organization has broad powers. It is entering into contract with each of its member organizations whereby all the live stock shipped to them may be sold through the new organization. It will thus handle and sell a large volume of live stock, either directly or through its member associations, as soon as it has machinery for doing so. It also has wide powers which permit the development of cooperative sales service on direct shipments of live stock from the country to the packers, without these shipments going through the terminal stockyards.

¹ *Ibid.*

² *Op. cit.*

It is planned to build extensive machinery for improved credit facilities for live-stock feeders and live-stock producers. In other words, the new national agency is planned to serve the live-stock industry in every capacity in which organized effort may be used to advantage.

While farmers generally have always been noted for their individualistic tendencies, that trait has been especially marked among live-stock producers. They were the last important group of American farmers to give cooperative marketing an extensive trial, though they have made rapid progress in the development of their cooperative selling organizations during the past fifteen years.

This trait of individualism cropped out in decided fashion, in the establishment of the National Live-stock Marketing Association, for almost half of the live-stock cooperatives refused to affiliate with it right at the start. They declined to cooperate on the ground that the new agency was granted too much power over the operations of its member organizations, and that it represented too great a movement for centralization of functions.

The following table indicates the general growth of business handled by the Livestock Terminal Market, Cooperative Sales Agencies.

TABLE 85.—VOLUME OF BUSINESS TRANSACTED BY THE LIVESTOCK TERMINAL MARKET
• COOPERATIVE SALES AGENCIES, 1920, 1925, 1929, AND 1934*
Revised Apr. 23, 1935

Calendar year	Associations listed	No. of animals received †				Dollar volume of business
		Cattle and calves	Hogs	Sheep	Total ‡	
1920	4	85,313	536,380	29,676	748,255	37,878,759
1925	28	1,881,241	7,377,084	1,350,311	10,666,069	279,720,654
1929	28	1,904,066	8,054,184	2,093,136	12,051,386	314,522,685
1930	30	2,088,411	7,259,731	2,609,604	11,957,746	273,688,165
1931	34	2,216,507	7,169,955	3,028,503	12,414,965	190,769,836
1932 §	38	2,120,480	6,352,022	3,306,425	11,778,927	127,813,049
1933 ||	41	2,315,000	7,575,000	3,390,000	13,280,000	138,434,000
1934 ¶	41	2,590,000	6,295,000	3,339,000	12,225,000	148,000,000

* 1935 Yearbook of Agriculture, p. 740.

† Includes some animals sold for yard traders.

‡ Includes animals not segregated by kind.

§ Estimates based on reports from 36 of the 38 associations.

|| Estimates based on reports from 39 of the 41 associations.

¶ Estimates based on reports from 35 of the 41 associations.

The large decline in the dollar volume after 1929 reflects the fall in prices of live stock since the decline in number of animals handled was very small. The number handled in 1933 was, in fact, the largest for any year; yet, the money returns were only about \$10,600,000 more than the bottom year 1932, when only 11,778,927 animals were handled.

The National Cooperative Council.—The cooperative associations, through their commodity federations, developed plans for a national

organization of agricultural cooperatives which is to assist in coordinating those business problems which are of common interest to all farm cooperatives. This organization, known as the National Cooperative Council, furnishes the agricultural associations a means for dealing with protective, educational, legislative, and other service matters of common interest to all agricultural cooperatives.¹ It is believed by some that the council should attempt to manage the surpluses, both export and domestic, through centralized buying and selling.

Attitude of the Public toward Agricultural Cooperatives.—The city worker, although he may belong to a trade union; the manufacturer, although he may belong to a strong manufacturers' association; and various dealers and bankers, although they may belong to their respective trade associations, look upon the agricultural cooperative movement with some misgiving. "If it succeeds, may the results not be adverse to my own interests?" is asked by each group. The answer is, the probability that the cooperative movement will succeed in permanently raising prices to such an extent as to materially affect the interest of any of the above-mentioned groups is very remote. Rising prices of agricultural products would tend to expand production among cooperative members, nonmembers, and in foreign countries to such an extent as to bring prices back to a reasonable level within a comparatively short time. The non-agricultural groups, however, should not expect to receive, on a long-run basis, the products of the farm at a price that is ruinously low. The agricultural group deserves a reasonable standard of living as well as the other economic groups in our industrial organization. The major objective of the cooperative movement is to accomplish this ideal.

The Failure of the Farm Board Plan.—The attempt of the Federal Farm Board to promote the growth of cooperative associations may be termed successful, but its attempts to control prices through the purchase of commodities and loans to cooperatives proved a dismal failure.² The plan might have succeeded under normal conditions, but the world-wide depression and the rapidly declining foreign demand for American agricultural products proved too great an obstacle to overcome. The plan, in fact, was never designed to perform such a herculean task. As production mounted and exports fell, in 1931 and 1932, the attempt at price maintenance had to be discontinued. The revolving fund of \$500,000,000 ceased to revolve, and the government found itself the

¹ CHRISTENSEN, CHRIS L., *U.S. Department of Agriculture, Circ. 94*, p. 65, August, 1929.

² The Federal Farm Board had a revolving fund of \$500,000,000, provided by Congress, which was used to support the market for certain agricultural products, especially wheat and cotton.

possessor of large quantities of wheat and cotton which it could not sell at a remunerative price. Attempts to persuade the farmers to reduce their production proved futile. Many farmers therefore lost faith in the plan and demanded something more effective. Large numbers of middlemen, manufacturers, and bankers were unfriendly to the plan and agitated constantly for a "change."

The Roosevelt administration soon replaced the Agricultural Marketing Act of 1929 with the Act of 1933 which created the A.A.A. and the F.C.A. These provided for "voluntary" reduction in production through the payments of cash benefits to the farmers, and for more liberal credit facilities. The droughts of 1933 and 1934, and the curtailed production on the part of the farmers, succeeded so well that the surpluses had disappeared by the first of 1935, and the country began to import wheat, corn, and some other agricultural products.¹ Prices received by the farmers in the meantime had, of course, risen materially. This success, however, brought the inevitable adverse reaction from the urban classes who saw the purchasing power of their money decline as food prices rose. The "farm problem" is still with us. The Farm Board plan and the A.A.A. plan did not solve the major problems. The Soil Conservation Plan, likewise, does not seem to offer the desired solution. The cooperative marketing plan is economically sound and socially desirable, but it cannot solve and in fact it was not designed to solve the economic, the social, and the political problems of agriculture.

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¹ During the first 6 months of 1935, according to the records of the A.A.A., there were imported into the United States 230,581 head of cattle; 12,178,644 bushels of wheat; 17,620,000 bushels of corn; 3,076,934 pounds of pork products; 44,099,721 pounds of beef products; and 21,500,146 pounds of butter.

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Questions for Discussion

1. "Cooperative marketing organizations among farmers have been the most successful of any form of cooperative enterprise in the United States." What is the extent of agricultural cooperation at the present time? Give current statistics. Do cooperatives offer the solution of our agricultural problems? What do you think of their future possibilities? Justify your answer.
2. It is contended that cooperatives can (a) improve the marketability of the product, (b) develop markets, (c) control the flow of goods to market, (d) improve the bargaining power of the farmers, (e) improve service and reduce costs, and (f) finance the production and marketing activities of the members. Give illustrations for each point. Do you believe that these objectives can be attained more satisfactorily through cooperative effort than through individual effort? Justify your answer.
3. What are the conditions necessary for the successful operation of an agricultural cooperative marketing association?
4. What are the major difficulties met in relation to membership? management?
5. "The marketing operations of the cooperatives are on a large scale." Compare and contrast their marketing problems with those of a manufacturer.
6. What significance do you attach to the fact that almost 30 per cent of the members of cooperative organizations belong to grain marketing associations, 20 per cent belong to dairy marketing associations, and approximately 16 per cent belong to live-stock cooperative associations? Formulate your answer after due consideration of the characteristic features of the products, the methods of production, nature of the demand, and nature of the existing marketing methods and organizations. Compare and contrast the cooperative marketing problems confronting the producers of: (a) fruits and vegetables; (b) poultry products; (c) cotton; (d) wool; (e) tobacco; (f) live stock; (g) wheat; (h) dairy products.
7. Why has the agricultural cooperative movement centered largely in Wisconsin, Minnesota, Illinois, North Dakota, Iowa, California, Kansas, and Nebraska?

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8. Cooperative associations may be classified on four different bases, i.e., (a) size, (b) membership affiliation, (c) structure, and (d) commodities handled. What are the principal divisions under each heading?

9. "The farmers' organizations which are trying to get higher prices for farm products are really engaged in extending the market for clothing and for every other product which farmers desire to consume." Explain this idea.

10. Outline the plan of organization and the marketing methods of the California Fruit Growers' Association.

11. Give the salient features of the organization of the Texas Farm Bureau Cotton Association.

12. Outline the plan of organization of the Land O'Lakes Creameries, Inc.

13. Compare and contrast the organizations of the Maryland State Dairymen's Association and the Dairymen's League Cooperative Association, Inc. Cf. *U.S. Department of Agriculture, Circ. 94*, or *U.S. Department of Agriculture, Tech. Bull. 179*.

14. What were the chief causes for the failure of the Tobacco Growers' Cooperative Association? Cf. *U.S. Department of Agriculture, Circ. 100*.

15. "These questions are asked, times beyond counting: are the large-scale cotton cooperatives a success; have they made money for the farmers; will they last; will they displace the traditional system; can they exercise monopoly control to the detriment of the consumers; can they control production; can they fix prices; can they improve farming technique; can they improve the standard of life for the cotton farmers?" Answer the questions for cooperatives in general.

16. How do you account for the declining interest in the agricultural cooperative marketing movement during 1933-1935? Can cooperative associations stabilize prices through "orderly marketing"? What is meant by orderly marketing? pooling?

17. Are the objectives of the agricultural cooperatives contrary to the interests of the consumer? Justify your answer.

18. Did the A.A.A. and the F.C.A. remove the major need for the agricultural cooperative associations? Justify your answer.

Assignment

1. Problem 2, p. 337. Kansas Cooperative Wheat Marketing Association.
2. Problem 1, p. 333. Burley Tobacco Growers' Cooperative Association.
3. Problem 1, p. 656. New England Milk Producers' Association—Prices.
4. Problem 1, p. 350. California Prune and Apricot Growers' Association.
5. Problem 1, p. 366. California Walnut Growers' Association—Grading.
6. Problem 1, p. 378. Staple Cotton Cooperative Association—Pooling.
7. Problem 1, p. 388. Central Cooperative Association—Scope of Activities.

CHAPTER XX

SOME ASPECTS OF FORMAL SOCIAL CONTROL IN MARKETING

Purpose of this chapter: To determine the nature and the extent of the formal prohibitions, restraints, regulations, and controls placed by organized society on marketing organizations, policies, and practices; to study the trend of such movements and attempt to analyze their influences on marketing effectiveness.

Marketing organization, policy, and practice have been subjected to an increasing amount of formal social control during the last twenty years. There has been a certain amount of formal control—the amount varying with the political and social philosophies of the times—over marketing activities from the early development of commerce and trade. The medieval town governments, for example, attempted to prevent the flow of goods to market from being artificially controlled by making certain obstructive acts illegal. Thus *forestalling*—the purchase of a large quantity of goods before they reach the market so as to get them at a low price and thereby realize an unreasonable profit by reselling at a high price—for example, was forbidden; likewise *regrating*—the purchase of all the goods in the market for the purpose of reselling them at a higher price—was not permitted. *Engrossing*—holding goods off the market while waiting for a higher price—was illegal. The doctrine of the *just price*¹ was widely held during this period.

As a nation develops and its form of civilization becomes more complex, conflicting economic and social interests arise. In a country such as the United States, which is organized on the basis of private property, individual initiative, and the profit motive, the tension arising from such conflicting interests becomes, at times, quite strained. As a result, demands for government control in the form of regulation, prohibition, and even state ownership and operation of certain activities are made. Social control, expressed through common, statute, and constitutional law, and through the decrees of bureaus and commissions, is much in evidence in the field of marketing.

Recent Trends toward Centralized Control.—There has been a very decided trend toward governmental participation in the affairs

¹ A just price was commonly thought of as one that would give the producer a *just living*, that is, suitable to his station in life. See "Just Price in a Functional Economy," by B. W. Dempsey, S. J., in the *American Economic Review*, September, 1935, pp. 471 ff.

of its nationals since the first edition of this book was published in 1931. The trend was in evidence in many parts of the world at that time, especially in Russia, Japan, Mexico, and Italy. These countries were later joined by Germany in the development of centralized governmental control over economic as well as political and social activities. Countries throughout the world, as we have noted previously in our discussion, have established a high degree of centralized control over foreign trade and finance. This practice was usually followed by establishing, or attempting to establish, governmental planning and centralized control over domestic production, commerce, and finance. The reason for this trend was the conclusion reached by some economists, sociologists, and politicians that the cause of the depression and the reason for its long continuance were the lack of united and intelligent action on the part of business men.¹ The way to remedy this situation, according to the contention, was to develop centralized planning and control under government leadership. This philosophy of the relation of government to business found expression in this country in the so-called New Deal legislation of the 1933-1936 period. The laws providing for the N.R.A. and the A.A.A., the Cotton Control Act, the Communications Acts, the Gold Reserve Act of 1934, the Securities Exchange Act of 1934, the Silver Purchase Act of 1934, the Jones-Costigan Sugar Act, the Wagner labor and the Guffey coal laws of 1935, and a number of others accomplished this centralization, on the statute book, in short order.²

During the 10-year period following the war there was a popular demand for "less government in business," but when the depression of the 1930's continued through the second, third, and fourth years, a great popular demand arose for "more government in business." In fact, many business men, merchants, manufacturers, bankers, farmers, and others begged for government planning, regulation, and control. A large proportion of them perhaps wanted control and regulation for their competitors rather than for themselves. Many business people believed that "cutthroat competition" was driving the country to destruction, and that the only solution was for the government to "fix prices" and regulate production. The national election of 1932 produced a group of new officials who were willing to meet this new demand. These officials were able to secure the services of a number of young university professors who believed the opportune time had

¹ It was also argued that selfishness, greed, and crookedness on the part of industrial and banking executives were important contributing factors.

² It is interesting to note, however, that before these controls were put into effect the Eighteenth Amendment to the Federal Constitution, which prohibited the production and marketing of alcoholic beverages, was repealed. For an interesting discussion of New Deal legislation see, "Legality of the New Deal," *Fortune Mag.*, September, 1935, pp. 63 ff.

arrived to introduce national planning and centralized control over many economic activities. Rugged individualism and *laissez faire*, it was argued, had been weighed and found wanting. The institution of private property and the prestige of individual initiative were placed under a cloud of disapproval. Commissions were appointed to collect information and to plan long- and short-range economic and social policies and projects; and administrations and bureaus were established to organize, supervise, regulate, and control production and marketing activities. New regulations controlling prices, wages, interest rates, hours and conditions of labor, quantities and qualities of production, and marketing methods, organizations, and practices were formulated and put into operation.

Not all business men, professors, and consumers, however, were in favor of all the various plans for centralized control. The following quotation represents an opposing view.¹

Among these lighthouses for business and social guidance, the one, perhaps, of greatest importance is that which warns of the certainty that any undue concentration of power will be abused. It matters little whether such power rests in the hands of capital, or labor, of farmers, or manufacturers; of those who have, or those who have not; of a business department, or of government itself—the abuses of power follow with remorseless certainty when concentration occurs, and checks and balances are removed.

Great business enterprises that have set up highly functional and centralized organizations have had to revert, in due course, to decentralized authority. The founders of our own government, Thomas Jefferson in particular, emphasized and reemphasized the need for compromise and for checks and balances—and in this they were reading only the plain and enduring lessons of human history.

The dangers in excessive centralization of power lie less in human viciousness than in the limitations of even the best of human intelligences, and in that loss of balance and perspective which seems to be the price inevitably paid by those who acquire great power. The temporary reward for a concentration of power may be increased speed and progress—but the end is shipwreck.

With this introduction to give us perspective, let us survey briefly the fundamental legal concepts underlying the relationship existing between the buyer and the seller.

The Contract of Sale and Purchase.—Those who engage in marketing assume certain duties, obligations, and liabilities; they are entitled also to certain rights and remedies, and are subject to certain definite consequences that result from the sales contract.² A contract of sale is an agreement whereby the seller transfers or agrees to transfer his property

¹ James W. Hook, *The Management Review*, Bull. of American Management Association, July, 1935.

² The Uniform Sales Act, which regulates the sale of goods, has been enacted in a large number of states. This act, in the main, follows the old common law views.

in goods to the buyer for a money consideration called the "price." When the result of the contract is to transfer the title to the buyer, there is a *sale*; when the contract calls for the transfer of title at some later date, there is only an *agreement to sell*. A sale or a contract to sell comprises a meeting of the minds of the buyer and seller as to the terms of sale, quality and quantity of the product, and the date and the conditions of delivery. The contract is not binding if fraud, undue influence, or duress has been used in consummating the agreement.

Obligations of the Seller.—Organized society says that the seller of goods owes certain obligations to the buyer. Among the more important ones recognized by the courts are: to deliver the goods in accordance with the terms of the contract; to deliver the quantity and the quality specified; to confer upon the buyer a good title to the merchandise; and to make good all representations and warranties expressed or implied in the contract of sale.

The common law recognized a rule known as *caveat emptor*—let the buyer beware. The buyer was assumed to be intelligent and shrewd enough to be able to protect his own interest. Public policy was supposed to be furthered by following this doctrine. There are, however, a few important exceptions to the full acceptance of the rule. The seller is assumed by the courts to give certain *implied warranties* unless the contract specifically states otherwise. Thus there is an implied warranty by the seller that he has a right to sell the merchandise, that the buyer shall have and enjoy quiet possession of the goods, and that they shall be free from any charge or encumbrance in favor of any third party; that is, in words of the courts, a warranty of title is assumed to be furnished. When goods are sold on description, there is an implied warranty that the goods delivered shall correspond with the description. Goods sold by sample must correspond with the sample, and be free from any defect rendering them unmerchantable which would not be apparent on reasonable examination of the sample.

If the seller violates these implied warranties, the courts grant the buyer certain *remedies*. Thus under certain conditions he may rescind the sale, return the goods and recover the purchase price, or keep the goods and sue for the breach of warranty.¹

Obligations of the Buyer.—The buyer likewise assumes certain specific obligations after the contract of sale and purchase is made. The more important ones are to accept and to pay for the goods. If the price has been agreed upon, that amount must be paid. If no price is agreed upon, a reasonable price, *viz.*, the market price, is commonly accepted.

¹ The laws provide special remedies when the goods are still in the possession of the seller, in transit, or have not been paid for. For a discussion of these technical points, consult an approved college textbook on commercial or business law.

If the time is not specified in the contract, and the intention of the parties at the time of the transaction is unknown, then the time of payment is generally considered to be *concurrent with delivery*.

Because some sellers follow practices that are injurious to the interests of the public and are unfair to competitors, the federal and state legislatures have passed laws designed to protect the interests of the buyers and to establish and maintain competition among sellers on a fair and ethical basis.

In order to protect both the buyer and the seller, and to supply the courts with reliable evidence as to the intent of the contracting parties, a number of the states have enacted laws that follow rather closely the provisions of the old English Statute of Frauds. Thus the sale of goods of a value above a certain specified amount must be evidenced (1) by acceptance and receipt of the goods or a part of them, or (2) by the payment of some part of the purchase price, or (3) by some note or memorandum in writing signed by the party to be charged or by his lawful agent. A contract to sell land, however, can be evidenced only by a formal written document.

Governmental Regulation in the Field of Marketing.—The manufacturers in the United States at an early date sought the assistance of the government in giving them preference in the home market by means of a protective tariff. Pure food and drug laws have been passed for the purpose of protecting the health of the consumer. Antitrust legislation has been enacted, designed to preserve competition and to protect the consumer from high prices, poor service, and low quality. The competitive practices among manufacturers and among merchants, and between these two groups, are closely scrutinized by state and federal officials. Laws authorizing the creation of machinery for regulating the prices of the services of such industries as common carriers and public utilities have long been in force.¹ The marketing practices of a

¹ Congress passed the Interstate Commerce Act, authorizing the creation of the Interstate Commerce Commission, in 1887. This body is assigned the task of regulating transportation rates and otherwise regulating and supervising certain activities of transportation companies. The Sherman Antitrust Act was enacted in 1890, and was supplemented in 1914 by the Clayton Act. The Federal Trade Commission is authorized to regulate certain phases of interstate commerce through inquiry into, and examination of, the methods used in marketing to determine whether unfair practices are being indulged in, or if the acts are in restraint of trade. If so, the Commission is to issue an order to "cease and desist." These orders are subject to court review if the company affected thinks they are unjust. Some other important laws that affect marketing practice are: the Uniform Sales Act, Uniform Warehouse Receipt Law, Uniform Bill of Lading Act, Uniform Stock Transfer Act, Negotiable Instrument Law, Packers and Stockyard Act, the Agriculture Marketing Act, a number of postal laws—among which is the Parcel Post Law; and, of course, much of the New Deal legislation.

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number of professional groups, such as physicians, lawyers, dentists, teachers, accountants, druggists, and real estate brokers, are regulated to a considerable extent by statutory laws. Special legislation affecting the marketing organization, policies, and practices of cooperative associations, labor unions, banks, insurance companies, and many other forms of enterprises is in operation and is being added to constantly.

Limitations on Marketing Practice.—A firm desiring to extend the market for its product through developing new uses for its merchandise, securing new users, and by divesting competitors of their customers must observe certain rules of law and orders of commissions which limit its choice of methods. The courts and commissions are likely to examine any policy or practice under consideration from the point of view indicated by the following questions:¹ (1) Is the *end* sought, *i.e.*, furthering one's trade success, legitimate and worthy of legal protection? (2) Are the *means* used legitimate and fair?

The operation of some forms of business is forbidden on the ground that they are contrary to sound social policy. Thus the sale of narcotics and a number of other products is prohibited. The federal government issues patents, copyrights, and franchises granting monopolies to private individuals and firms in order to encourage inventions, promote literary and artistic development and to protect the public from undue exploitation. The performance and sale of some services, such as the postal service, are monopolized by the federal government.

The question with reference to methods used raises the question as to what means and practices of the seller are legitimate and fair, and what ones are unfair. The determination of these facts requires an examination of the relation of the seller to the public, to the trade, and to his competitors.

The Machinery of Regulation.—Experience has proved that modern marketing organization, practices, and problems are too complex to be satisfied by the common and equity laws; recent experience also establishes the fact that statutory law cannot foresee and provide for many of the exigencies that rise during the evolution of modern marketing practice. As a result, it has been found advisable to set up a commission whose duty is to survey the general field of marketing policy and practice and to examine specific instances to determine whether the policies and practices questioned are legitimate, fair, or unfair. The establishment of the Federal Trade Commission is a recognition of the fact that "the law as a means and not an end, should not be stationary. It should be capable of modification, adaptation, and reinterpretation in the light of changed conditions and new thought in the fields of public

¹ Cf. Spencer, W. H., *Law and Business*, Vol. II, p. 4.

activity which it serves."¹ The code authorities attempted to go farther than the Commission could under the law.

The Federal Trade Commission.—The Sherman Act was designed to break up monopolies and to prohibit any acts that were considered to be in restraint of trade or commerce among the several states. The Clayton Act is more specific in that it makes the discrimination in price between different purchasers unlawful if the discrimination tends substantially to lessen competition or to create a monopoly. The law does not prevent price differences based on differences in grade, quality, quantity, or in costs of transportation and selling. Different competitive situations were also to be given due consideration. A seller was to be permitted to choose his own customers so long as his practice was not in restraint of trade.

The function of the Federal Trade Commission is to examine the conduct of "any person, partnership, or corporation" engaged in *inter-state* commerce to determine whether certain specified practices constitute unfair methods of competition in commerce. The Commission may act upon a complaint of any competent individual or may proceed on its own initiative. The Federal Trade Commission Act declared unfair methods in commerce to be unlawful, and empowered and directed the Commission to prevent the use of such unfair methods of competition.²

Unfair Practices.—A difficult situation immediately arises in attempting to determine what practices are unfair. There is, obviously, much room for differences of opinion. Congress recognized this fact and provided for the examination of the Commission's decisions by federal courts upon an appeal by the affected party. The courts have, in fact, on numerous occasions reversed the Commission's decisions. No attempt has been made by the Commission to define "unfair methods"

¹ *Harvard Business Review*, Vol. IV, No. 3, p. 362.

² Congress has specifically exempted certain types of organized effort from the Sherman and Clayton acts and the supervision of the Federal Trade Commission. Thus labor unions and agricultural cooperative associations are not now subject to prosecution because of monopolistic tendencies growing out of their particular types of organization. The railroads, banks, and public utilities have their own specialized regulatory commissions. Production of oil, transmission of messages and intelligence, the carrying on of export trade, and a number of other activities have been expressly exempted from the operation of the antitrust law. Apparently, the law is still in full force with reference to import trade transactions, and to the domestic marketing of manufactured goods. Even in these fields the recent activities of trade associations and trade practice conferences lead one to wonder whether the widespread use of the antitrust law has not become somewhat antiquated. During the era of the N.R.A., enforcement of the antitrust laws was frankly ignored by the federal government. After the demise of N.R.A. the Commission invited industry to submit voluntary codes for approval.

in general terms. Each case is treated as an individual problem. The facts in the particular case determine whether the acts are unfair.¹

During the course of years that the Commission has been in operation, it has declared several hundred acts to be unfair. For the purpose of this discussion, these unfair practices may be grouped under two major headings, *viz.*, unfair practices that directly affect the interests of the public, and those that affect the interests of competitors.

Unfair Practices That Affect the Interests of the Public.—The eagerness of some sellers to extend the market for their goods causes them to lose sight of the welfare of the consumer. Those producers, merchants, and marketing agencies that can most effectively and satisfactorily serve the buyer deserve to succeed. A firm, however, may be eminently successful, yet be grossly inefficient. It may, through the power of great financial resources or dishonest and unethical practices, crush competing firms which may be more efficient and more worthy of public patronage. The consumer as an individual is hardly in a position to protect his interests against such unscrupulous practices. Organized society acting through its legally constituted supervisory body, the Federal Trade Commission, can be more effective. It should be kept in mind, however, that the jurisdiction of this body is limited to interstate commerce. The malpractices of the local retailer, wholesaler, and manufacturer have to be handled by state authorities, the better business bureaus, and trade associations.

Retailers use unfair methods when they advertise greatly reduced prices, fire sales, bankrupt stock, and removal sales, when, in fact, they are merely selling their regular merchandise in the normal way. The consumer is led to believe he is securing good values at greatly reduced prices, when, in fact, he may be offered inferior values at exorbitant prices. The merchant in such instances is attempting to take advantage of the faith and the ignorance of the consumer. A similar form of dishonest practice is engaged in by those merchants and manufacturers who advertise furniture as solid mahogany, walnut, or oak, when it is only veneer, or, worse still, a cheap grade of inferior wood stained in such a manner as to deceive one who is not familiar with the different kinds of wood. Clothing, blankets, and other textile products have been proclaimed to the public as being constituted of wool and silk, when only a small amount of these materials was present in the fabrics. Mattresses have been sold as containing new and fresh felt, cotton, and other acceptable materials, when, in fact, they were stuffed with dirt, refuse, and other inferior and unsanitary filling.

¹ Unfair competition, according to the Pan-American Trade-Mark Conference, is every act or deed contrary to commercial good faith or to the normal and honest development of industrial and business activities.

The following news release issued by the Federal Trade Commission on May 22, 1935, illustrates the type of control exercised by this governmental agency.

The Federal Trade Commission has ordered sixteen companies engaged in the dressing and dyeing of furs, and one importer, in New York City and its vicinity, to cease and desist from misleading representations in the sale of their products. All of the respondents consented to the orders.

Description of furs in any way other than by the use of the correct name of the fur as the last word of the description, is prohibited in the orders. When any dye or blend is used to simulate another fur, the true name of the fur appearing as the last word of the description must be immediately preceded by the word "dyed" or "blended," compounded with the name of the simulated fur.

Use of the word "seal" and the words "Hudson seal," alone or in connection with other descriptions, are not to be used unless and until they are compounded with the word "dyed" and followed by the true name of the fur, as "seal-dyed muskrat," "seal-dyed cony," "Hudson seal-dyed muskrat," or "Hudson seal-dyed cony."

The order prohibits employing the word "seal" or the words "Hudson seal" alone or in combination with other words (regardless of corporate name, trade name or trade mark), except that the words "seal" or "Hudson seal" may be used as adjectives to describe the color or character of the dye of such fur, as "seal-dyed muskrat," "seal-dyed cony," "Hudson seal-dyed muskrat," or "Hudson seal-dyed cony."

Fruits and vegetables have been preserved by the use of chemicals that are harmful to the consumer. Adulterated foods and drugs have been sold as first-class goods. Because of the nature of such products and the method of packaging, it is obvious that the consumer is not able to judge the quality. He necessarily must depend upon the honesty of the manufacturer and the merchant. When these business men become so unmindful of the welfare of the consumer as to resort to such unfair and dishonest practices, they should not be surprised when the outraged citizenry secures the enactment of drastic laws designed to eliminate these abuses, or that honest business men devise means, such as the better business bureau and truth-in-advertising legislation, to control the small minority of malpractors.

Some merchants pay their salesmen extra bonuses if they succeed in selling their out-of-date, shopworn, or otherwise undesirable articles to some of the unsuspecting customers. The extra incentive encourages the salesman to make untruthful and exaggerated statements. Such practice will probably do the merchant more harm than good, as the customer is likely to learn eventually that he has been tricked. When he does, he will surely not have a very friendly feeling toward the firm. The more businesslike method would be to mark down the price and dispose

of the article in the usual way. Other unfair practices sometimes encountered by the consumer are: the delivery of merchandise not quite equal to the quality described in the advertisement, promised by the salesman, or indicated by the sample; the giving of short measure—packages may not contain the specified amount, the containers may have false bottoms, the scales may give short weights, or the clerk may hold his hand on the scales or not completely fill the measure. A number of states have passed laws providing for periodic investigation of weighing and measuring devices. Federal laws require that the amount of the contents of bottles, buckets, and other containers and packages be printed in a conspicuous manner on the outside of the container.

The Control of Resale Prices.—The Sherman Act clearly prohibits business firms from entering into agreements to fix or control prices. Such acts are interpreted as being in restraint of trade and tending toward monopoly. They are interpreted as being against the interests of the consumer. The right of the owner, however, to fix the price at which his property shall be sold or used "is an inherent attribute of the property itself."¹ He can refuse or cease to sell to anyone for any reason or no reason. Manufacturers, however, have repeatedly attempted to form agreements with dealers to maintain a certain resale price. The general tenor of the Sherman Act and of the Clayton Act is against such practices. Some manufacturers have devised many ingenious methods in their attempts to circumvent the laws.

The producers that have spent large sums of money in advertising their products dislike to see the large-scale retailers use them as loss leaders. The manufacturers claim that the sale of these goods at greatly reduced prices injures their prestige and causes independent dealers to refuse to handle their goods. This, it is claimed, results in great loss to the manufacturers. A large number of cases dealing with the manufacturers' attempts to control resale prices have been taken up by the Federal Trade Commission, and many orders to cease and desist have been issued. The following discussion indicates the opinion of the courts.

Attitude of the Federal Courts toward Resale Price Maintenance.—An analysis of some of the decisions of the courts and orders of the Commission is helpful to the extent that it indicates the original policy of these bodies. These rulings cannot be taken too literally, however, as a

¹ There is a definite limitation that the student should not forget. Businesses "affected with a public interest" are subject to a certain amount of government regulation and control. Thus railroad, public utility, and telephone rates are subject to federal and state regulation. Some legislators apparently wish to designate a number of other business activities as being so endowed. Thus milk has been classed as a "public utility"; some natural resources, such as coal and petroleum, are believed to be "endowed with a large amount of public interest" by many interested parties.

small difference in the facts of a given case may lead to a decision which might not be expected. Under present practice of the courts there are a number of methods which the manufacturer *cannot use* to secure a standardized resale price. Thus the Federal Trade Commission, supported by the courts, has seemingly firmly established the doctrine that the fixation of the resale price by cooperative means constitutes an unfair method of trading.

A survey of the cases brings to light a number of practices which have been judged to be of a cooperative nature or otherwise objectionable, and for which orders to cease and desist have been issued. Thus in the Houbigant case¹ the Commission decided the following acts to be of a cooperative nature:

1. Entering into contracts, agreements, or understandings with dealers, distributors, or any of them for the resale of the manufacturer's products at prices fixed by him.
2. Procuring either directly or indirectly from dealers promises or assurances that the resale price fixed by the manufacturer will be observed by the dealer.
3. Requesting dealers to investigate and report to the firm the names of other dealers who do not maintain the resale price.

In the Q.R.S. Music Company case the Commission disapproved, with the sanction of the court,² of the following practices:

1. Requiring promises or assurances from dealers who have been cut off because they were cutting prices, that they would in the future maintain the fixed resale prices as a condition of reinstatement.
2. Attaching any condition expressed or implied to purchases made by distributors or dealers to the effect that they shall maintain resale prices set by the manufacturer.
3. Refusing or threatening to refuse sales to dealers who have been reported by other dealers to be price cutters.

The Commission, with the approval of the court, expressed disapproval of the following practices in the Hill Bros. case:³

1. Requiring purchasers or prospective purchasers to agree not to resell below a minimum price specified by the manufacturer.
2. Utilization by this firm of its salesmen for the purpose of enforcing cooperation in the resale price maintenance plan, by reporting dealers who do not observe the resale price.
3. Compiling lists of dealers as undesirable purchasers who are not to be supplied with the products of the firm unless and until they give satisfactory assurances of their intention to maintain the resale price fixed by the manufacturer.

¹ *Federal Trade Commission Docket* 1250, Apr. 2, 1926.

² 12 Fed. (2d) 730.

³ 9 Fed. (2d) 481.

There are other practices that have been condemned by the Commission, such as:

1. Solicitation and securing from customers or prospective customers themselves or from dealers or trade associations information as to whether or not such customers or prospective customers do maintain the fixed resale price.
2. Soliciting and securing reports from customers of customers who do not maintain the resale price.
3. Requiring an extra price from price cutters during a probation period as a condition on which they may be reinstated on the regular basis.

What Can a Firm Do?—While a firm has the privilege of selecting its customers and has the right to suggest the resale price, yet the cases cited above show only too clearly that it must be very careful about the methods used in exercising the right. Interpreting the policy of the Commission on the basis of decisions rendered prior to the code era, it appears that a firm may use the following methods in its attempt to maintain resale prices:

1. Request its customers not to sell its products at less than a stated minimum price.
2. Refuse to sell to a customer because he resells below the requested minimum price or because of any other reasons.
3. Announce in advance its intention to refuse to sell.
4. Inform itself through its soliciting agents and through publicly circulated advertisements of customers which come to its attention and through other *legitimate*¹ means, *without* any cooperative action with its other customers or other persons as to the prices at which the product is being sold.²

The firm may, when the method is feasible, control the resale price by establishing and operating its own retail outlets and branches. It can use the consignment method, thereby retaining the ownership of the goods and all the rights and privileges that go with ownership. The firm may, within certain limitations, establish agency contracts with dealers and thereby be in a strategic position to suggest prices. This plan, however, is not practicable when goods are sold through wholesalers.

Attempts to Legalize Price-maintenance Agreements.—The legal difficulties encountered by the producers and merchants interested in the control of resale prices have led them to work for the passage of a law that would permit the practice. The Capper-Kelly bill is designed to meet this desire. To be more specific, the stated purpose is "to give the vendor of a trade-marked or branded article the legal right to contract for the resale of that article at a stipulated price, and that the vendee will require a similar contract on resale."

¹ Italics are the writer's.

² Cream of Wheat case, 14 Fed. (2d) 40, U.S. Circuit Court of Appeals, 8th Circuit.

If this act should become a law, contracts providing for the maintenance of resale prices would become legal and enforceable in the law courts. The bill at one stage of its hectic course contained the following provisions:

That no contract relating to the sale or resale of a commodity which bears (or the label or container of which bears) the trademark, brand, or name of the producer or owner of such commodity, and which is in fair and open competition with commodities of the same general class produced by others, shall be deemed to be unlawful, or against the public policy of the United States, or in restraint of interstate or foreign commerce, or in violation of any statute of the United States, by reason of any agreement contained in such contract:

1. That the vendee will not resell such commodity except at the price stipulated by the vendor; and/or
2. That the vendee will require any dealer to whom he may resell such commodity to agree that he will not in turn resell except at the price stipulated by such vendor or by such vendee.

It will be noted that the bill is applicable only to trade-marked goods that enter into interstate and foreign commerce. Intrastate transactions are under the jurisdiction of the various state courts.¹ Furthermore, the act does not legalize any contract or agreement between producers, or between wholesalers, or between retailers as to sale or resale prices.² Provision is made to meet certain emergencies; thus the commodities under contract may be resold without reference to such agreement, in closing out the owner's stock; in case the commodities have become damaged or deteriorated in quality; or they may be sold out at a reduced price by a receiver, trustee, or other public officer acting under the orders of any court.³

Unfair Practices against Competitors.—A number of unfair methods of competition appear in the attempts of manufacturers and merchants to establish, maintain, and extend the market for their goods. One is to cut prices with the intention of not only extending the market for their goods but also to crush the competitor and secure his customers. The next step after the competitors have been eliminated is to raise prices higher than they were during the time of normal competition and thereby injure the consumer. When price cutting leads to monopoly,

¹ During 1935, eight bills introduced in state legislatures became laws legalizing some form of price maintenance; fifteen were killed or died before they could be passed; three were passed by the legislatures but were vetoed by the governors.

² Sec. 3 of the bill.

³ Sec. 2 of the bill. This bill lay dormant during the N.R.A. regime, when codes of "fair competition" were permitted. The sponsors felt they could attain their objectives through the code provisions. After the demise of the codes, however, the sponsors of the Capper-Kelly bill again became active.

it is illegal. If a firm reduces prices in line with its lower costs of production, the act is not illegal or unfair, even though the price is materially below that of competitors. The management under such circumstances should receive the commendation of organized society as a public benefactor. The situation is entirely different, however, when a firm with wide distribution reduces prices in one territory or district for the purpose of driving out financially weaker competitors, and maintains or even raises prices in other districts where there is no appreciable competition.¹

The method may take a different form, as when a large corporation utilizes an undisclosed subsidiary to cut prices while the parent company religiously maintains the regular prices. The odium of price cutting falls on the bogus independent while the real offender may remain in high esteem. A firm may maintain the customary price on its regular products but put out the same quality of product in a different package, under another label, and cut the price on this new line with the intention of driving out competition and establishing a monopoly. Sometimes unbranded goods are used for price-cutting purposes. Again, prices may be maintained, but excessively liberal credit terms, trade-in terms, delivery, and other services may be given which virtually reduce the price charged the buyer. Prizes, premiums, stamps, and other "free" goods and services are used to give the same effect as price reductions. These practices, it might be argued, should be welcomed by the buyer. Such might be the case if they were made in good faith, but when they are followed for the purpose of reducing competition and ultimately raising prices, the best interests of the consumer are not served.

There is a long list of miscellaneous dishonest, unethical, and unfair methods. Thus a firm may hire men to follow the representatives of its competitors, as they visit their customers and prospective customers. The purpose is to get a list of its competitors' prospects and customers, and then try to sell them its own product. Frequently the customers are urged to break their contracts; the competitors are defamed; and their goods disparaged. Some firms have even gone so far as to tamper with, for instance, the machinery sold by a competitor so it will cause dissatisfaction and the customer will cease his dealings. Threats against customers of competitors have been made so as to force them to turn from the original seller to the aggressor. The employees of competitors have been hired at unreasonably high pay so as to secure from them

¹ There seems to be no legal restraint against the reduction of prices on a single or limited line of products by a merchant selling an extensive list. Thus grocery and drug chains cut the prices of cigarettes, much to the discomfiture of the more highly specialized tobacco chains. The former depend largely upon their non-tobacco products for profit, while the latter appear to be helpless unless they diversify their activities. This practice ceased during the period of the codes, but reappeared shortly after the court decision.

important trade secrets; espionage and stealing have been used for the same purpose.

The use of tying contracts, exclusive agencies, rebates, and refunds is illegal when they tend to create a monopoly, restrain trade, or substantially reduce competition. Influencing dealers to refuse to handle a competitor's products, thus depriving him of suitable channels of distribution, is unfair. The use of threats, intimidation, and other high-handed methods to force dealers to handle the complete line of a manufacturer is illegal. A concerted and extensive boycott of a producer's goods and the blacklisting of the producer or merchant are usually regarded as unfair practices.

Unfair Practices, According to the Codes.—The opinion of a large group of producers and merchants as to what actions should be classed as unfair is indicated by the provisions in the now defunct codes. The following table gives the twenty actions that were most frequently mentioned in the first 200 codes approved. The table lists the practices believed to be unfair, and the number of times each was barred in the first 200 codes. These figures clearly indicate the code makers' interest in prices.

Unfair Practices ¹	No. of Times It Appears
Cost, selling below.....	146
Bonuses, rebates, unearned discounts.....	139
Bribery.....	119
Defamation of a competitor.....	115
Discrimination between customers.....	102
Misrepresentation.....	101
Contractual relations, interference with.....	100
Price cutting below published list.....	100
Invoicing, improper.....	99
Advertising, false or misleading.....	96
Marking or branding, false.....	87
Distress merchandise, disposal of.....	82
Piracy.....	76
Consignment sales and/or shipments.....	72
Price guarantee.....	61
Transportation allowance.....	58
Price increase greater than justified by conditions.....	51
Espionage.....	43
Substitution.....	41
Free deals.....	36

¹ This list was published in *Domestic Commerce*.

Legalizing Restrictive Activities.—Since retail merchants are not engaged in interstate commerce, some retail merchant associations have been active, in a number of states, in securing state legislation and city ordinances that aid in reducing competition by preventing the operation

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of certain types of selling. While there is no doubt about the unfairness of some of the retailing methods used, one has difficulty in discovering any unfairness in other methods about which the merchants complain. It appears in many instances that the local retailers, instead of fighting against practices that tend to restrict trade and promote monopoly, are striving to prevent and reduce competition. They are, in other words, working for their own selfish interests rather than protecting the welfare of the public. Taxes are levied and fees charged by local governmental bodies, in an attempt to prevent peddling, house-to-house selling, chain-store operation, and other forms of retailing that are likely to reduce the sales of the local merchants. When these newcomers use unfair methods or false advertising, or make untruthful statements, give short weights, and otherwise attempt to deceive and swindle the consumers, they should be dealt with severely.¹ But when they follow well-accepted or efficient methods and sell dependable merchandise, the interests of the consumers rather than those of the dealers should govern the actions of the city councils, better business bureaus, and the state legislatures.

The following summary of a report made by Dr. Ryan indicates, very briefly, some forms of local governmental regulation of marketing activities.²

Out of approximately 130 activities of retail merchants, which cover all operations in the field of retail distribution, about 25 or 30 activities were found to be normally subject to some regulations of municipalities. There are generally special ordinances affecting specifically about 50 kinds of businesses, accounting for about half of the retail business of the country, and licensing regulations are common for all types of business.

Some of the ordinances common to many cities deal with the regulation of store location (zoning), weights and measures, food inspection; use of sidewalk displays, signs and awnings, billboards; and protection against fire hazards. Some cities have comprehensive regulations covering door-to-door selling, "closing-out" sales, distribution of handbills, selling through vending machines, and other ordinances which exert a wide influence on all retail merchants in the community. All cities should have ordinances to: (1) regulate location of stores, (2) control use of public property, (3) protect health, (4) prevent deception of the public, (5) prevent retail sales of stolen goods, and (6) reduce fire hazards.

Ten states, among which are California, New York, Wisconsin, and New Jersey, have passed laws that permit fixing the resale prices of

¹ Unfair competition, embracing all acts characterized by bad faith, deception, fraud, or oppression, including commercial bribery, is wasteful, despicable, and a public wrong.

² "How Cities Control Retailing," quoted from *Sales Management*, pp. 494 ff., Nov. 1, 1934.

identified merchandise through a contract, expressed or implied, between the producer and the wholesaler or the retailer, under certain restricted conditions. These laws have not been thoroughly tested as to their constitutionality. There is some doubt as to whether they will survive such a test in their present form. These laws, however, do not legalize price fixing among merchants and among manufacturers, as was the case with some of the codes.

Attitude of the Federal Trade Commission.—The following statement of the creed of the Federal Trade Commission expresses its point of view prior to the N.I.R.A.

Firms that follow the precepts of the golden rule need have no fear that they are unwittingly violating the law.

We do not believe that success is a crime, failure a virtue.

We do not believe wealth presumptively wrong, poverty right.

We do not believe that industry, economy, honesty, and brains should be penalized, their opposites glorified.

We do not believe that big business and crooked business are synonymous.

We believe that 90 per cent of American business is honest, is eager to obey the law. We want to help this 90 per cent.

We want to control or destroy the 10 per cent that is crooked.¹

The Federal Trade Commission recommended the following amendments to the Clayton Antitrust Act. The purpose of the amendments is to increase the power of the Commission so it can head off "the steady trend toward monopoly."

To preserve equality among buyers by preventing sellers from discriminating in price without limit whenever there was a difference in the quality or quantities sold.

To maintain a competition between individual corporate units by making illegal the acquisition of control in one corporation by another, regardless of whether competition between the two is actually reduced as a result.

To empower the Commission to compel the divesting of physical property acquired in violation of the proposed amendment immediately preceding.

To extend the Commission's jurisdiction to include unfair methods of competition and unfair or deceptive acts and practices "in or affecting" interstate commerce.

¹ HUMPHREY, WILLIAM E., "Not Guilty Until Proved," *System*, p. 156, February, 1927. It is interesting to note that one of the first acts of President F. D. Roosevelt was to "summarily and arbitrarily" remove Mr. Humphrey from the Federal Trade Commission in 1933. The Supreme Court of the United States ruled, in 1935, that the President did not have the power to discharge such officials "without cause." Mr. Humphrey had died in the meantime, so the personnel of the Commission remained unchanged. The Commission, however, had been rather inactive during the period of the codes.

The Commission maintains that ,

The practice of giving a large buyer disproportionately large discounts has been recognized as a powerful instrument in building up monopoly. Different prices are justified only on actual difference in costs.

Under the proposed amendment the prices charged would have to be reasonably related to the differences in cost and could not be so great as to produce an unfair or unjust discrimination.¹

We need rules and regulations that promote competition on a higher plane than would normally be followed if free and unrestricted competition were allowed. Regulation should not be based on the point of view that the inefficient should be protected from the efficient. This policy would lead to higher prices which would be at the expense of the consumer. Society should not be forced, as a general practice, to accept rules that reduce or eliminate competition. Rules and regulations that take into consideration the reasonable and just interests of the buyer and the seller should be formulated. The interpretation and enforcement of these rules should be performed by a competent and impartial agency. The decisions of this agency should be subject to court review.

Some Legal Aspects of Trade-mark Usage.—A manufacturer, merchant, or other person who has the initiative and ingenuity to place on the market a product that he thinks the public wants may identify it by a distinctive trade name, trade-mark, or package. The laws of the land encourage the exercise of such initiative by granting protection from unfair competition through copying or otherwise using the identifying feature in an attempt to take advantage of the goodwill created by the original user. Imitating the identifying features used in connection with an article already on the market is regarded as an attempt to pass off spurious goods on the public as the genuine article, and is held to be unfair competition. The assumption is that the means used are dishonest; or that, by imitation of name or device, there is a tendency to create confusion in the trade and enable the seller to pass off upon the unwary public his goods as those of another, and thereby deceive the purchaser; or that, by false representation, it is intended to mislead the public, and to induce it to accept a spurious article in the place of one it has been accustomed to buying. The determination as to whether there is infringement, and whether the welfare of the consumer has been injured, sometimes presents a difficult problem. The situation

¹ The new wholesale tobacco distributors trade practice rules approved by the F.T.C. during the latter part of 1935, provide: (1) loss leaders, price discrimination, and allowances are forbidden; (2) selling below cost not permitted. Cost is defined as invoice cost and replacement cost plus the cost of doing business. These provisions virtually duplicate the tobacco code under the N.R.A.

raises a question of fact which may require careful investigation to answer. The testimony of the ordinary witnesses usually called before the court may be unreliable. The services of an experienced psychologist may be necessary to determine whether the consumers have been misled or deceived.

The Registered Trade-mark.—A manufacturer or merchant, in selecting a trade-mark, should select one that can be registered,¹ and one that is not likely to be confused, in the mind of the buyer, with some other existing form of identification. The name of a place or person, or one that is descriptive of the quality of the goods cannot be registered because they are not susceptible of exclusive use.² Even though a trade-mark may be registerable, it may be a poor means of identification because of its similarity to some existing mark or one that may be developed for the purpose of competing with the original.

Rights to the Use of a Trade-mark.—If a manufacturer wishes to secure a legal right to use a particular trade-mark, certain precautions must be taken. The commissioner of patents and the courts have held that the right to the use of a trade-mark can be established only through the use of the trade-mark on a *specified article* or class of goods. There is no such thing as property in a trade-mark except as a right appurtenant to the established business or trade in connection with which the mark has been used. A seller therefore has no property in the mark *per se*, but only in reference to his trade, and cannot prevent another seller from applying this mark to goods which are not of the same descriptive properties.

The Beech-Nut Packing Company, which manufactures a wide variety of food products, was refused the right to register its trade-mark for cigarettes which the company at the time did not manufacture or sell. The P. Lorillard Company,³ a manufacturer of tobacco products, was using the same trade name, Beech-Nut, on some of its cigarettes—the company had formerly used the name on a smoking and chewing tobacco. The packing company, which had been using the name on its food products, attempted to obtain an injunction enjoining the tobacco company

¹ Some of the advantages derived from registration are: (1) It is *prima facie* evidence of appropriation and use, but of course is not conclusive. (2) It constitutes a public notice of the mark selected, *i.e.*, constructive notice. (3) The mark is examined by an official who gives an opinion as to whether the identifying feature can or cannot be used as a legal trade-mark. (4) Registration establishes a *prima facie* case on the validity of the mark. (5) A case of infringement can be taken into the federal courts, which may be of distinct advantage. (6) The owner of the registered mark is entitled to triple damages in certain cases, *e.g.*, willful infringement.

² Neither can the pictures of the president, the flag, coats of arms or other insignia of the United States or of fraternal organizations be registered as trade-marks.

³ 299 Fed. 834.

from using the trade name. The court refused the injunction on the well-established principle that "the establishment of the right to the use of a trade-mark on one class of merchandise does not necessarily carry the right to use the trade-mark on merchandise of different descriptive properties."

A Trade-mark for a Family of Products.—It is a well-settled doctrine that the same mark may be used by different concerns for different articles. Prior use, however, of the trade-mark by another firm on merchandise of different descriptive properties gives it precedence as far as that class of merchandise is concerned. A manufacturer sometimes encounters difficulties when he attempts to develop a family of products under the same trade-mark, if the added new lines have been previously sold under similar trade-marks by another firm. The Beech-Nut case is an apt illustration. This doctrine of the courts definitely limits the freedom of action on the part of the seller. He may be prevented from grouping a variety of products under a "blanket" or "family" trade-mark. In addition, overemphasis of the doctrine that the right to the use of a trade-mark is usually confined to merchandise of the same descriptive properties causes considerable confusion in the mind of the buyer. For example, consider the case of goods of different properties which are produced and branded by different firms, but have the same or similar trade-marks, and are sold by the same retailer. The consumer might be familiar with one product sold under a certain mark, and upon seeing a different kind of product sold under the same or similar mark, in the same store, might naturally assume it to be produced by the firm with whose product he is familiar. Thus he might logically think that Polo cigarettes and Polo food products were produced by the same firm.

It would seem that an economic viewpoint would demand that the agencies through which the merchandise reaches the consumer be given as much consideration as the character of the merchandise. Thus if the merchandise reaches the user through the same retail outlet, and if the same or similar trade-marks are used on goods of different descriptive properties, the buyer is quite likely to be misled as to the origin and ownership of the goods. This situation certainly presents an important problem to the creator of a given trade-mark. He should so design his proposed symbol as to prevent it from taking on not only any of the essential characteristics of one used on a competing line, but also of one that is used on a product that will reach the consumer through the same retail outlets.

Adjusting the Trade-mark to Changing Conditions.—The user of a trade-mark occasionally finds it desirable to modernize or otherwise revamp his old trade-mark. The question immediately arises as to

how far he can go without abandoning his old identifying feature and without creating the problem of establishing a new one. This question is difficult to answer. If the accumulated goodwill is to be carried over, the new mark or name must be so much like the old one that the buyers will still be able to recognize it.¹ It is obvious that the revised mark should not be of such a character as to be easily confused with some already existing trade-mark used by a competing firm.

A business having once established its right to use a particular trade-mark must use it continuously in order to maintain this right. When a company abandons the use of a certain identifying feature, it loses all its rights to such mark or symbol. The general rule followed in determining whether a trade-mark has been abandoned seems to be the intention of the owner. If the user did not intend to abandon, under certain conditions, the legal right to the use of the mark may lie dormant for years.

Trade Associations and the Law.—A trade association is an organization of producers or distributors of a commodity or service built upon a mutual basis for the purpose of promoting the business of their branch of industry and improving their service to the public through the compilation and distribution of information, the establishment of trade standards, and the cooperative handling of problems common to the production or distribution of the commodity or service with which they are concerned.² The association represents a cooperative attempt on the part of industry to solve the problems of trade relation and to develop a certain amount of self-regulation.

According to former Attorney General H. F. Stone:

Practically every industry has its trade association. Many of these are operating along lines which are entirely lawful and of considerable benefit to the members and to the public; some are groping in the twilight zone of illegality; a few are wholly illegal.³

There is a strong desire among firms within an industry to reduce unfair and dishonest practices and to promote efficiency. There is always present, however, the temptation to extend their efforts, while attempting to accomplish these ends, so as to violate the antitrust laws and the rulings of the Federal Trade Commission. Agreements and concerted action are equally unlawful if the means used are illegal or if legal means are used to gain an unlawful end. An attempt to bring about an illegal concert of action is equally objectionable.⁴ When there is, for example, a combination on the part of the members of a trade

¹ The problem here is psychological rather than legal.

² Adapted from a definition by the American Trade Association executives.

³ "Trade Association Activities," *Domestic Commerce Ser. 20, 1*, U.S. Department of Commerce.

⁴ *Ibid.*, p. 53.

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association to secure concerted action which actually results in a restraint of commerce and in curtailment of production, producing an increase in price, it is clearly illegal. The codes attempted to make legal many of the desires of the trade associations. The codes furnished a legal device for coercing the recalcitrant "ten per cent" of an industry.

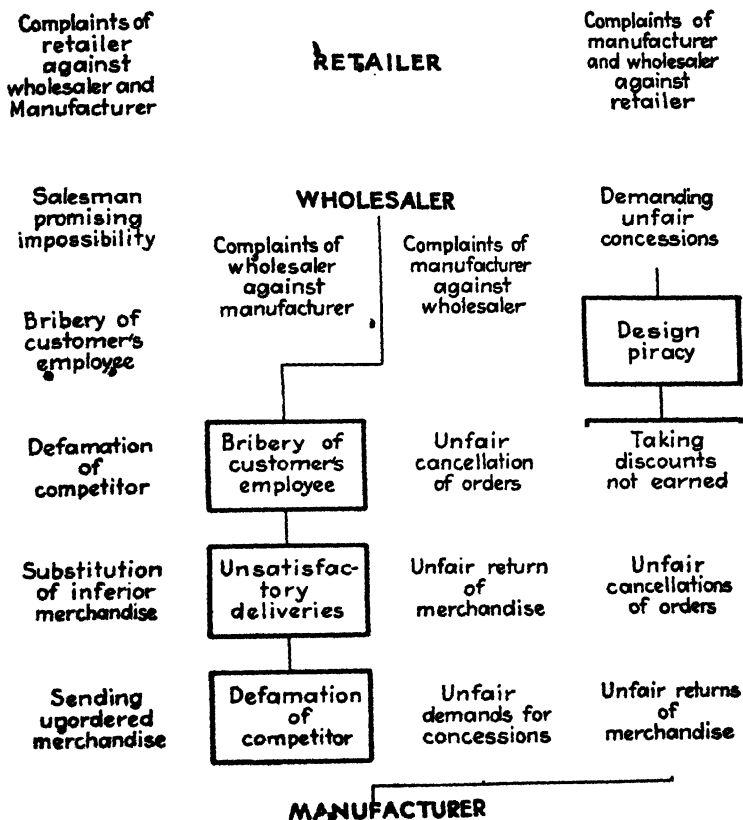


CHART XXII.—Sources of complaints concerning unfair practices. (Published in *Domestic Commerce*, Apr. 30, 1935.)

Trade Abuses.—Among the more serious trade abuses complained of generally by manufacturers and merchants are unjust returns of merchandise, failure to deliver at appointed time, misrepresentation of merchandise by salesmen, unreasonable cancellation, disregard of shipping instructions, salesmen promising things employers cannot fulfill, selling competitors when line is stated to be exclusive, salesmen urging retailers to overbuy, failure to confirm orders, delivering merchandise not according to sample or to specification in an order, accepting orders

which cannot be delivered, delivering more than was ordered, taking discounts not earned, delivering imperfect or ~~season~~ goods, unreasonable demands for concessions, and delivering goods ahead of invoice.¹

Trade associations, of which there are several hundred in the United States at the present time, have done much through education, codes of ethics, commercial arbitration, and the prosecution of offenders, to correct these and other troublesome abuses.² They have done much to promote efficiency and to reduce waste in marketing and production by collecting and widely disseminating information concerning stocks on hand, volume of sales, and prices of past transactions; through conducting industrial and commercial research; establishing uniform cost-accounting methods; and fostering simplified practice and industrial standardization. These associations can and do render a valuable service to industry as reliable fact-finding agencies.

Chart XXII, prepared by the Committee on Unfair Trade Practices in Production and Distribution, shows the major complaints of unfair trade practices between retailers, wholesalers, and manufacturers.

Distinction between Regulation and Restraint of Trade.—Some of the associations apparently have difficulty in distinguishing between a *regulation of trade* and a *restraint or a restriction of trade*. The following quotation indicates this lack of distinction.³

There are numerous decisions holding, as violative of the antitrust laws, combined attempts on the part of members of trade associations to control, restrict, or dictate the channels of distribution of commodities or to classify the trade so as to announce persons with whom it is permissible for members to deal.⁴ Such acts transgress not only the *Sherman Act*,⁵ but the Federal Trade Commission

¹ *Ibid.*, p. 108.

² "Selected Trade Associations of the United States," published by the Department of Commerce, listed 2,500 national and interstate trade associations in the 1935 edition.

³ KIRSH, B. S., *Trade Associations: The Legal Aspects*, pp. 246 ff.

⁴ The leading authority on this point is *Eastern States Retail Lumber Dealers' Association v. United States*, 234 U.S. 600, 609 (1914). The later decisions are applications of the general principles there announced. - (Cf. Kirsh, *ibid.*)

⁵ *Eastern States Lumber case*, *supra* note 2; *United States v. Southern California Wholesale Grocers' Association et al.*, 7 Fed. (2d) 944 (1925); *United States v. Southern Wholesale Grocers' Association et al.*, 207 Fed. 434, 439 (1913). It is to be noted that in *United States v. Trenton Potteries Co. et al.*, 273 U.S. 392, 394 (1927), the second count of the indictment, upon which the jury also convicted the defendants, alleged a combination among the defendants to restrain interstate commerce by limiting sales of pottery to a special group known to respondents as "legitimate jobbers." Since the conviction was affirmed on the count alleging an agreement to fix prices, the court did not enter into the question raised by the defendants, as to the second count. (Cf. Kirsh, *ibid.*)

Act as well.¹ In general, the cases are of two classes, the first attempting to compel the exclusive use of one method of distribution, namely, through a certain class, as wholesalers or retailers; the other involving attempts on the part of some organized group, denominated "regular" or "legitimate" dealers, to compel distribution through that particular group. Restraints of trade, in this field, involve attempts to force commodities to flow in particular channels of distribution. They embrace such generic concerted activities as arrangements among independent retailers to refuse to deal with producers or wholesalers who sell directly to chain stores, mail-order houses, department stores, other large-scale consumers, or ultimate consumers; arrangements to compel producers to confine their sale to certain named distributors; or arrangements among wholesalers to refuse to deal with manufacturers who sell to retailers.²

Maple Flooring and Cement Cases.—Prior to 1925 the Federal Trade Commission and the federal courts were very critical of association activities. But beginning with the decisions rendered in the Maple Flooring Association and the Cement Manufacturers' Protective Association cases "the emphasis in legal inquiry has shifted from a search for a technical violation of the antitrust laws to proof of presence of substantial economic benefits."³ Mr. Justice Stone, speaking for the majority of the Supreme Court, stated, in the Maple Flooring case:⁴

We decide only that trade associations or combinations of persons or corporations which openly and fairly gather and disseminate information as to the cost of their product, the volume of production, the actual price which the product has brought in past transactions, stocks of merchandise on hand, approximate cost of transportation from the principal point of shipment to the points of consumption, as did these defendants, and who, as they did, meet and discuss such information and statistics without, however, reaching or attempting to reach any agreement or any concerted action with respect to prices or production or restraining competition, do not thereby engage in unlawful restraint of commerce.

This decision announces no new rule of law and rescinds no old rule.⁵ The court in the two cases mentioned above makes a clean-cut distinction

¹ *Pacific States Paper Trade Association et al. v. Federal Trade Commission*, 4 Fed. (2d) 457 (1925), affirmed 273 U.S. 52 (1927). Accord: *Arkansas Wholesale Grocers' Association et al. v. Federal Trade Commission*, Cir. Ct. App., 8th Circuit, 18 Fed. (2d) 866 (1927), *certiorari* denied, 48 Sup. Ct. 30; *Southern Hardware Jobbers' Association et al. v. Federal Trade Commission*, 290 Fed. 773 (1923); *Wholesale Grocers' Association of El Paso, Texas, et al. v. Federal Trade Commission*, 277 Fed. 657 (1922); *Western Sugar Refining Co. et al. v. Federal Trade Commission*, 275 Fed. 725 (1921); *National Harness Manufacturers' Association v. Federal Trade Commission et al.*, 268 Fed. 705 (1920). (Cf. Kirsh, *ibid.*)

² Strenuous efforts have been made since 1933 to secure legislation that would legalize the above-mentioned acts.

³ Kirsh, *op. cit.*, pp. 11 ff.

⁴ *Maple Flooring Association v. United States*, 268 U.S. 563.

⁵ "Trade Association Activities," *op. cit.*, p. 51.

between courses of conduct which had not previously been stated; agreements or concerted action that *tend to curtail production, enhance prices, or restrain competition* are still illegal. Information of a certain kind may be collected and legally discussed by an association provided it is disseminated extensively at the proper time and in a suitable manner. Information secured collectively must be used only for individual action. This idea is well stated in the following quotation.¹

Any group action which will make the individual members of an association more useful, better informed or more efficient units of an industry may be highly proper, but such action must not deprive any unit of the industry of its freedom of action, nor lessen its right to be guided in its activities by independent and individual judgment. Nor may a trade association, the legality of which lies primarily in its functions as an agency for the collection, compilation, and distribution of trade statistics—a fact-finding agency in every sense of that term—enfold a smoke screen of protection around its members by virtue of its importance in modern business, or camouflage, by virtue of its dignity and standing, practices in restraint of trade in which any two of the most humble of its competing members could not lawfully indulge prior to its formation. Competitors may not in the name of an "Association," "League," or "Institute," indulge in sales practices forbidden to other members of society.

Food and Drug Legislation.—A food and drug bill known as S-5, which is designed to prohibit certain forms of objectionable advertising, has passed the Senate. Section 601 of the bill provides that

. . . an advertisement of a food, drug, device or cosmetic shall be deemed to be false if it is false or misleading in any particular relevant to the purposes of this Act. . . . Any representation concerning any effect of a drug or device shall be deemed to be false . . . if . . . not supported by demonstrable scientific facts or substantial and reliable medical or scientific opinion.

The bill specifically brands as false any public advertisement of a drug or device representing it to have any therapeutic effect in the treatment of Bright's disease, tuberculosis, cancer, infantile paralysis, venereal disease, and heart and vascular diseases.² This legislation would affect only interstate commerce. A large number of states have pure food and drug laws that affect the marketing of these products through intrastate commerce.

Federal Control of Agricultural Marketing.—We have referred previously to the great powers granted by the A.A.A. legislation to the Secretary of Agriculture. He could impose processing taxes and pay benefits for crop control in connection with certain basic commodities, *viz.*, wheat, rye, barley, flax, cotton, field corn, grain, sorghums, hogs,

¹ TAYLOR, W. B., *Commerce and Finance*, pp. 924 ff., May 7, 1930.

² *Sales Management*, July 1, 1935.

cattle, rice, tobacco, peanuts, potatoes, sugar beets and sugar cane, and milk and its products. The 1935 law granted the Secretary of Agriculture authority to issue orders to dealers and processors of milk, fruits and nuts (excepting apples), tobacco, and vegetables—fruits and vegetables for canning were excepted. For milk the A.A.A. had power to set minimum prices for each classification of the product on the basis of use, and to specify when payment should be made. Orders on fruits and vegetables would have limited the amount of production that could be marketed, or transported to market, or purchased from producers; provided for the disposition of surpluses and equalized the burden of surplus elimination among the producers and handlers; and provided for minimum prices under certain conditions. Thus the dealer in fruits and vegetables could buy them only in the quantity, from the producer, and at the price ordered by the Secretary; and the producer could sell only the amount permitted, ship it to the market specified, at the time permitted, and at the price specified.

Parties to marketing agreements were required to furnish the Secretary certain specified information. The new law called for additional information and gave the Secretary access to their books, records, accounts, correspondence, and income-tax returns in order to verify reports submitted. The law provides that 30 per cent of the annual customs receipts be turned over to the Secretary of Agriculture for use in encouraging exports of agricultural products, purchasing or leasing submarginal land, and in making certain forms of benefit payments. The Soil Conservation Act has many features similar to some of those in the A.A.A. law that was declared unconstitutional. The Supreme Court decision did not affect the marketing agreements of the 1935 act.

Trade Practice Conferences.—The Federal Trade Commission, before the advent of the codes, indicated its willingness to cooperate with industry in establishing a high degree of self-regulation by creating a Trade Practice Conference Division. The director of this division confers with the representatives of an industry that feels the need for regulation within its own ranks. The director may act on his own initiative or at the request of representatives of the industry to find out whether a sufficient number of the members want a conference to make a meeting truly representative of the industry. If and when the meeting is called, one of the commissioners presides. The meeting, however, is independent and is free to take what action it wishes. It may adopt rules for the guidance of the industry. If the resolutions condemn practices that are manifestly illegal, the Commission will aid the industry in enforcing them, if it is necessary.

The Commission, however, ceased during 1930 to sponsor regulations forbidding practices which were merely unethical or disadvantageous to

the industry as a unit.¹ "It should be borne in mind that these rules are the rules of the industry, sponsored and adopted by the industry itself, and are not regulations which the Commission is undertaking to impose upon the industry." Some leaders of business believe that if an industry can set up its own standards of conduct which will serve adequately to protect the public interest, all occasion for government intervention will be removed.²

Considerable objection developed against this liberal attitude of the Commission. During 1933, however, the general idea was revised, made much more liberal, and given the sanction of governmental edict in the form of codes. Public opinion and the Supreme Court were not convinced that the right solution had been found.

Professor Nystrom states that³

... the purpose of a fair trade practice rule is to eliminate dishonest, tricky and underhanded methods of trade and to permit a fairer and freer field of competition. In the development of the Fair Trade Practice Conferences under the Federal Trade Commission this view was generally and fairly well observed. Accordingly certain practices were condemned and prohibited such as unfuthful advertising; false statements concerning competitors; espionage; commercial bribery; attempts to induce breach of existing contracts; imitation of competitors' trade marks, trade names, designs, containers or products; inaccurate grading and false reports on tests; intimidation and coercion; misleading guarantees; and so on.

All regulations of this type are useful and necessary aids to fair competition. All are desirable, not only from the standpoint of business, but also from the standpoint of public policy. These provisions tend to eliminate the thief, the cheat and the crook. They help the honest individual or concern to compete on an even basis with those who might otherwise obtain business by trick or deceit. These provisions raise the plane upon which competition may be carried on, but they do not lessen competition. They encourage each concern to use its best endeavor by fair and honest means to secure increased business. They encourage legitimate reductions in prices, improvements in quality, and better service. Under these rules any concern, efficiently operated, offering what consumers want, has a chance to survive and to succeed. Under such regulations competition is made truly serviceable to society.

Commercial Arbitration.—Another evidence of the desire of business to develop self-regulation is the rapid growth in the use of commercial arbitration since 1920. This plan provides for keeping a large number of disputes that arise between buyers and sellers out of the law courts. Many trade associations have incorporated an arbitration clause in their uniform contracts. This clause provides for the settlement of any disputes which may arise under the contract, according to the plan of

¹ KETZLOGG, W. F., *Trade Relations and Trade Associations*, p. 6.

² The code builders heartily disagreed with this point of view.

³ NYSTROM, P. H., "Trends Dangerous to Consumers under the NRA," published by *Institute of Distribution, Inc.*, May 1, 1935.

arbitration adopted by the industry or association. A number of associations require the prospective member to agree to the arbitration of certain forms of disputes as a condition of membership. Refusal to arbitrate is punishable by expulsion, and this applies in disputes between a member and a non-member as well as between members of the association. Other trade associations do not make arbitration compulsory, but if both parties voluntarily agree to arbitrate, then they provide for enforcements of the awards. Several states have enacted laws making the clauses in the contracts enforceable by law. The same is true under the Federal Arbitration Act which applies to admiralty transactions and in interstate commerce disputes involving more than \$3,000.

The dispute is usually submitted to an arbitration board comprising three members. Each contestant chooses a member of the board; these two choose the third member. One member is elected by the group as an umpire. This plan makes it possible to select members of the trade or industry who are well acquainted with the parties, their businesses, and the custom of the trade. Lawyers are not necessary; in fact, they may be prohibited from appearing in a case. The parties appear before the board to give their testimony, then retire while the case is discussed and the decision formulated. The procedure is very simple; all technical phraseology is eliminated; the hearings are private; there is no delay in the hearing and adjudication of the dispute; the cost is small; and the likelihood of bitter feeling arising, as a result of the belief that one party has not been treated fairly, is small.

Governmental Regulation and Control through Taxation.—The marketing activities of a number of producers, merchants, and other functionaries are greatly affected by taxes. The practice of collecting a tax on the sale of an increasing number of products and services is growing apace. Some of these levies are state taxes, and some are federal taxes.

State Taxation and Marketing.—The marketing of a number of products is greatly affected by taxation. Some taxes are levied and collected for the purpose of raising revenue. Illustrations of this type of taxation are the state and federal taxes on gasoline, tobacco products, electrical energy, and gas. Some taxes, such as the processing taxes, are designed to collect revenue from one portion of the population so that it can be distributed to another group. There are a number of taxes used to control or to eliminate certain types of marketing institutions or products. Thus the chain-store taxes that have been passed by some states,¹ e.g., Indiana, Iowa, and California, have as their major

¹ Chain-store tax bills were introduced in nineteen state legislatures during 1935; four passed and became laws, twelve were killed, and three were still pending in July. Seventeen states had chain-store taxes at the beginning of 1935; there were approximately twenty at the close of the year.

objective to place the chain stores under such a handicap that they cannot compete successfully with independents. Chain organizations with large numbers of stores located in a given state have been forced to cease operation in some of the states.¹ The usual practice is to use a graduated tax that increases rapidly as the number of stores operated in the state by one ownership body increases. Thus the per store tax for a company operating one hundred stores is much higher than for one operating ten stores.

Some of the dairy states are taxing oleomargarine as much as 15 cents a pound, which has the effect of eliminating this product as a competitor of butter. If the price of butter should rise too much, bootlegging of oleomargarine would, no doubt, appear.

A number of states have enacted general sales tax laws.² These laws usually exempt the "necessities" of life; i.e., certain food and clothing products. The following quotation³ summarizes the findings of the Interstate Conference on Conflicting Taxation with reference to the sales tax situation.

Studies by the Interstate Conference on Conflicting Taxation and other research bodies have fully developed the merit of sales taxes as a ready means of raising large amounts of revenues. However, the principle and desirability of sales taxes is still highly disputed. That retailers and certain groups of consumers are also becoming more active in contesting the passage of sales tax statutes is evidenced by the circulation of petitions for referendums and petitions to initiate amendments exempting certain types of commodities. Retail interests are usually protected by provisions in the laws providing for retailer collection of the tax from the consumer.

The new sales tax statute of Ohio has provided for 100 per cent passage of the tax to the consumer by a tax receipt system. This law is unique in that the retailer purchases tax receipts in advance and gives the customer a ticket which is cancelled at the time of the sale transaction. The Ohio law also grants the retailer a 3 per cent commission on tax collected for cost of handling and cancelling the tax receipts.⁴

Likewise, the statutes of Colorado permit the retailer to retain 5 per cent of the tax collected to cover his expense of collecting and reporting the tax. A majority of the statutes in general provide that the retailer shall not absorb or advertise to absorb the tax and that the tax is to be collected according to a sales breaking point schedule. Retailers are confronted with a difficult problem in passing to

¹ Some oil companies have ceased to operate their filling stations.

² Prior to 1935 sixteen states had enacted sales tax laws; of the twenty-nine state sales tax bills introduced in the several legislatures during the first half of the year, fourteen were passed, fourteen were killed or died, and one was still pending in July.

³ WARHURST, H. P., Retail Trade Section, Marketing Research and Service Division, Department of Commerce. Published in *Domestic Commerce*, May 16, 1935.

⁴ A municipal judge in Akron declared the law unconstitutional on Aug. 9, 1935. The decision was of course appealed to a higher court.

the customer taxes of less than 2 per cent of sales. Some statutes make no provision for method of passing tax to the customer.

The migration of retail trade to tax-free stores or districts has been of concern to retailers as well as the state administrators of sales taxes. The Interstate Conference on Conflicting Taxation in a resolution endorsed the resolution introduced in Congress by Senator Harrison, which would grant the state the right to tax sales in interstate trade on an equal basis with intrastate sales.

The Arkansas sales tax statutes provide for equalization of sales tax rates with the rate in adjoining states by boundary towns and cities. However, an injunction has been granted against the collection of the Arkansas tax so that there is no measure of the merit of this means of protecting the retail trade of the state. Other states have enacted or amended licensing statutes in such a way as to require the payment of the state sales tax before an automobile may be licensed to operate in the state. Washington (state) imposed a 2 per cent tax on all goods exceeding \$20 in value purchased outside of the state and then brought over the state border.

Attempts to raise the tax rate have been the cause of much legislative confusion. In Missouri, Oklahoma, and Illinois this fight has been the most publicized phase of the legislative session.

It may be said that at this early date that the sales tax situation among the states is in a state of flux, with changing rates, amendments to existing laws, litigation and petitions the order of the day. It would appear that the outstanding issues confronting sales taxation today are:

1. Desirability of this type of tax.
2. Passage of tax to the consumer, implying the inability of the retailer to collect all of the taxes which he must pay the state.
3. Migration of trade to tax-free states.

The chief advantage of the sales tax, from an administrative point of view, is that it is more dependable than many other forms of taxation.¹ It is comparatively easy to collect; it cannot be evaded, is "painless," has a low cost for collection, and places the burden on "spending" instead of penalizing saving. There are, however, some rather decided objectionable features to the general sales tax. This form of taxation falls on all consumers irrespective of their ability to pay. The person with a small income may pay as large a tax on many commodities as the person with a large income. There is little relation between benefits received by the individual and the amount of tax paid. A high rate encourages tax evasion and bootlegging. The ease with which this

¹ A retailer may be subject to a large number of different kinds of taxes—too many in fact to be enumerated here. The Kroger Grocery and Baking Company, for example, stated in its annual report that it paid no less than twenty-nine separate and distinct taxes; the total amount of the payments equaled \$9.00 a share, 7.3 per cent of the total volume of net sales, and 34.3 per cent on the invested capital. The net earnings of the company equaled after the various payments \$2.29 a share. *Magazine of Wall Street*, p. 495, Aug. 31, 1935.

form of tax can be collected tends to promote a multiple tax. Thus an individual may be forced to pay a federal, a state, a county, and a municipal sales tax. This situation now exists in some places in the case of gasoline and cigarettes.

Federal Tariffs and Taxes.—The desire of certain economic groups, both capital and labor, to improve their competitive position has led them to seek preferential treatment in the home market by means of a tax or tariff levied on competing imported goods. This tax tends to raise the prices within the importing country and at the same time tends to lower the price paid to the exporting country. The result is a tendency for production within the importing country to increase, thereby giving more employment to certain forms of capital and groups of labor; and for production within the exporting country to decrease, with corresponding effects on the employment of labor and capital. The consumers of the protected country will usually have to pay a higher price for the protected articles but seldom, if ever, will the increase in price be equal to the full amount of the tariff. There are instances, however, in which the tariff will cause no increase in price. The price of an article is determined by the action and interaction of those complex forces commonly designated as supply and demand. If a country supplies all its own needs, a duty obviously will have no effect on the price paid by the buyer for the home supply. The import tax cannot cut down supply and thus affect prices. Demand will not be changed under the conditions mentioned. When a country has a large export surplus, a tax levied on imports—of which there normally will be none—will, of course, not raise prices.¹

Economic Implications of a Tariff.—A tariff, then, usually tends to benefit some individuals and injure others. The question is: Whom does it benefit and whom does it injure, and to what extent? What is the net effect upon the country as a whole?²

Much time and energy have been expended in arguing these questions. These discussions have been characterized by the display of considerable passion and emotion. Large volumes of facts and figures are collected and displayed, usually for the purpose of proving a point—creating an impression—rather than finding the truth. The determination of the truth, in fact, is no easy task. Much careful, painstaking,

¹ There may be an exception to this generalization in the case of a country with extensive geographical distribution; for example, if the producing area is centralized in a small section along one boundary, and there is a large demand in another section of the country far removed from the area of production but near the source of supply in another country.

² This is not the place to go into the various arguments for and against free trade and protection. The purpose of this discussion is merely to point out the importance of the problem as it affects general marketing organization and practice.

and dispassionate study is required to ascertain just what the economic, social, and political effects of a particular tariff law will be, or just what the effects are or have been. Conditions within a country and throughout the world change so rapidly and so unexpectedly that the results may be entirely different from what was expected. A tariff affects different interests in different ways and in varying degrees. Importing merchants want no duties on the merchandise imported. The laborer as a consumer wants no taxes on his purchases, but as a worker in a given industry he may be violently in favor of protection. He may desire no tax on merchandise, but demand restricted immigration so as to keep out foreign laborers, and want his labor union exempted from the action of antitrust laws. The manufacturer and the producer of raw materials may favor free trade when they dominate the home market and want to develop markets in foreign lands. They may want protection when the home market receives large quantities of competing goods from abroad.

Exaggerated Claims.—The desire of each group to further its own interest by either a tariff or free trade has developed many unique arguments. Their zeal to prove their contention has led both sides to make extravagant and unwarranted claims. P. G. Wright, a former member of the Tariff Commission, delineates this situation rather succinctly in the following words.¹

Free traders say that protection raises the price of the protected article and is therefore a serious burden on consumers. They say that it enables manufacturers to make enormous profits at the expense of the people. Some of them call it simple robbery. They make lists showing the quantity of protected articles consumed and the duty on each; then, multiplying the quantity by the duty, they arrive at imposing figures running into the billions purporting to show the extent of the plunder.

Protectionists, on the other hand, say that protection spells prosperity. They deny that it raises prices, except perhaps temporarily. They say that it stimulates and diversifies industry, that it gives employment to labor, maintains wages, affords a home market for the products of the farm, promotes national security. On the other hand they paint a most gloomy picture of what would happen if protection were removed. Many thriving industries would be destroyed, laborers would be thrown out of employment, those that retained their jobs would find their wages reduced to the level of the wages paid to the "pauper labor of Europe," farmers deprived of the home market would be unable to sell their crops except at ruinously low prices, the country, no longer self-sustaining, would be at the mercy of the enemy in the event of war.

Recent Trend toward Protection.—Since 1920 there has been a decided movement among the various nations to protect and encourage

¹ Wright, P. G., *Protection, Benefits, and Burdens*, p. 5, published by the Rawleigh Tariff Bureau.

home industries through establishing quotas and duties on imports, and the granting of bounties and other aids to the local producers. Even England, which has been the outstanding example of a country prospering under the benefits of free trade, has levied a considerable number of protective duties.

Some Arguments for Free Trade.—Free trade, theoretically, would be the best national policy for a country to adopt.¹ This plan would allow each nation to produce those goods and services for which its natural resources and native genius and ability^a made it best suited. The surplus goods could then be exchanged for the surplus goods produced to best advantage, or at the least disadvantage, in foreign lands. If a country could not produce any goods or services at a lower cost than other countries, transportation costs considered, then it could concentrate on those that it could produce at least disadvantage.

The situation becomes somewhat complicated, however, when some countries insist on enacting tariff laws. Unless all leading nations should adopt the free-trade plan, certain disadvantages for the free-trade country are sure to arise. The experience of England, although it is a country that imports raw materials and foodstuffs which its manufacturers and laborers want to come in free, and its own manufacturers until recently dominated both the home and foreign markets for a large number of goods, indicates that as conditions change a different policy may be forced upon a free-trade country.

Some Arguments for Protection.—There are three principal reasons why countries lean toward protection in spite of the apparent advantages of free trade: (1) The growth of the spirit of nationalism, which causes each nation to want to be as near self-supporting as possible. This may be an expensive luxury, but all races and nationalities seem to display this characteristic. The World War apparently greatly stimulated the nationalistic spirit. Protection tends, it is claimed, to promote diversity of industry and occupations and to stimulate invention. These may be worth more to a nation's welfare than the increased material wealth that might result from free trade.* (2) Protection may be necessary to start a new industry which will eventually develop to such an extent that it will not need further protection. The steel industry of the United States is an illustration; the chemical industry is apparently approaching this condition. Some industries based on inventive genius

¹The arguments for free trade are based upon the following assumptions: (1) that competition is free and unrestricted; (2) that the end of economic activity is only the creation and consumption of wealth; (3) that the test of a national policy is the creation and existence of the maximum aggregate of wealth; (4) that there are differences between countries with respect to their natural resources and the abilities and inclinations of their inhabitants. Cf. WRIGHT, *op. cit.*

and exploited by efficient and resourceful management soon reach a point where no protection is needed or desired. The automobile, farm implement, office appliance, electrical machinery, and heavy industrial machinery producers are in this group. They feel secure in the home market and want no duties for fear that they will promote retaliatory tariffs which will hinder their exports. Countries that attempt to keep foreign products out by a high tariff may find the foreign countries establishing branch plants or subsidiary firms within the protected country so as to get within the tariff wall and thereby enjoy the benefits of the protection. The country usually does not object to this action as the industry employs local labor, buys domestic raw materials, and may export some of the finished product. (3) The most dynamic reason for protection, according to Dr. Wright, is that foreign trade is conducted, not between nation and nation in the form of an exchange of goods for goods, but between private individuals in the form of an exchange of goods for money. The emphasis is placed on securing a large amount of money for exports and paying out a small amount for imports. The value of money, after all, however, is measured in terms of the amount of goods it can command in exchange.

The Effect of a Tariff on Prices, Production, and Consumption.—Whether a tariff raises prices to the consumer depends upon whether it reduces the supply of the article in the protected market. The immediate effect of a duty is the tendency to reduce the amount of an article imported. If the domestic production increases to an amount equal to the decrease in imports, the supply remains the same, and there is no change in price.

If the product is produced under conditions of increasing costs, the price will have to advance in order to bring out the added production. If, however, the goods were produced under conditions of constant costs, output could be increased without an increase in price; and, if the industry could bring into play the elements of decreasing costs, production could be increased indefinitely with a possibility of ultimately reducing prices. This would happen only in case of active competition among domestic producers.

If domestic production does not increase the full amount, then supply will be less and the price will rise—assuming no change in demand. Whether the price rises the full amount of the tariff depends upon the responsiveness of domestic production and the willingness of foreign producers to absorb part of the tariff charge. If the duty is placed on an article not produced in the domestic market and one that cannot be produced under existing conditions, the supply will tend to decrease and the price will rise. Whether the final price will reflect the total amount of the duty depends upon the comparative elasticity of the demand

and of the supply.¹ Thus if the demand is highly elastic and the world supply highly inelastic, only a small portion of the duty will attach to the price, and the burden of the tariff is borne chiefly by the foreign producer. When conditions are reversed, the consumer will pay practically the entire duty.

Changes in prices are sometimes attributed to tariff changes, when, in fact, such is not the case. When the duty on sugar was raised in 1930, the retail price of the product, instead of advancing as was predicted by the opponents of the tariff, declined throughout the summer. Again, when the tariff on sugar was greatly reduced during the first Wilson administration, the retail price during the course of a few years advanced from \$5 to \$30 a hundred pounds. Thus in one instance prices came down when a tariff was raised, while in another they went up when a tariff was reduced. The explanation is that in the first instance there was a condition of over-production and a world-wide depression, with declining commodity prices; in the second case there was a world war, with tremendous changes in the supply and demand factors. When there is world-wide over-production of a commodity, a buyer's market results, so that prices may work lower than they were prior to the imposition of the tariff. During a period of world-wide undersupply, such as occurs during a period of a war, drought, or a breakdown in transportation facilities, the producers and merchants are likely to charge what the consumer will pay. Costs of marketing and of production, under such conditions, may bear little relation to retail prices. The abolition of a tariff would probably make little change.²

The effects of a particular tariff rate, as stated above, are so difficult to determine that generalizations are often misleading. The following statement presents the reasoned judgment of a careful student of the subject as to the general effects of a tariff on domestic prices.³

1. The more the domestic elasticity of supply exceeds the foreign elasticity of supply the less will be the effect of the duty on the domestic price and the greater will be the effect of the duty in increasing domestic production.

2. The more the domestic elasticity of demand exceeds the foreign elasticity of demand the less will be the effect of the duty on the domestic price and the greater will be the effect of the duty in reducing domestic consumption.

¹ Cf. CARVER, T. N., *Principles of Political Economy*, Chaps. XXVIII, XXIX.

² The comparison of prices before and after a change in tariff rates is not always dependable due to the possibilities of such general price changes. The more reliable method of measuring the effect of a tariff upon prices is to compare prices within the tariff wall with those outside the wall. Care must be taken, however, to give due consideration to the costs of transportation, and other charges necessary to get the goods to the port of entry.

³ WRIGHT, *op. cit.*, pp. 22 ff.

3. The smaller the imports the less will be the possible increase in price resulting from a duty. (If imports are very small compared with domestic production, a slight increase in price will make the duty prohibitive, after which any increase in the duty will have no effect.)

4. The results in 1, 2, and 3 will be reversed when the conditions are reversed.

Applying these conclusions to the United States it may be stated that an industry which readily lends itself to mass production by the use of power-driven machinery or an agricultural product well adapted to the soil and climate of the United States and readily substituted for some other crop of which we now have an export surplus, are industries which lend themselves to the application of protection. A moderate duty would probably cause domestic production greatly to increase, and the country would become self-sustaining with little burden to consumers. On the other hand industries of which the product cannot be increased without a considerable increase in cost, and these include agricultural products ill adapted to our soil and climate or for which the well-adapted regions are very limited, are unfavorable to the application of protection. Consumers will be heavily burdened and while some producers may make large profits the prospect of building up a strong self-sustaining industry is not great.

The practice of nations since 1931 has placed less emphasis on tariffs, and more on quotas, embargoes, bounties paid to their own nationals, and the rigid control of foreign exchange rates. A number of foreign countries have followed the practice of making available a limited amount of foreign exchange that could be used to pay for imports. Thus the central governments were able to control the selection of imports and dictate the quantity brought in. A large number of nations have attempted to force exports through devaluing their own currencies and by paying bounties to their domestic producers. A law has been enacted by our own Congress to set aside a portion of our tariff receipts to be used to pay bounties to the producers of certain agricultural products that enter the export market. One weakness of such a plan is that it promotes what is universally recognized as "dumping." This practice, similar to the practice of devaluation of domestic currencies, invites similar action on the part of other nations. The result is likely to be a race in dumping. Another weakness of the plan is that foreign countries can easily establish quotas and embargoes. Such plans consequently furnish no permanent solution to the problem.

Some Apparent Effects of Recent Governmental Restrictions.—The following quotation serves to summarize the effects of some of the forms of governmental regulation of foreign trade that have been in effect since 1927.¹

The desire of industrial nations to attain self-sufficiency with respect to farm products has frequently been recognized as a fundamental cause of the world-

¹ An editorial published in the *New York Journal of Commerce*, June 6, 1935.

wide depression. A more exact picture of the extent to which this factor has contracted world markets for agricultural staples, and thus depressed prices and disrupted the international balance of payments of many countries, is now presented in a report issued by the Economic Committee of the League of Nations.

The league experts have found that aggregate imports of wheat and wheat flour of the world at large declined from an annual average of 223,000,000 quintals for the years 1927 and 1928 to only 116,000,000 quintals in 1933 and 1934, a drop of fully 48 per cent. Similarly, the balance of imports of beef and veal for the principal importing countries declined from 1,122,000 tons in 1927 to 743,000 tons in 1933, a decline of 33 per cent. Corresponding declines are shown in aggregate imports of live cattle, dairy products and other staple

This severe contraction in world import markets for farm products is ascribed primarily to higher tariffs, the imposition of import quotas and other restrictions. These measures have raised prices to consumers in importing countries, and such higher prices in turn have discouraged consumption. At the same time, they have stimulated increased production of agricultural commodities in these countries. Thus, the report points out that in 1928 the price of wheat in France was 118 per cent of the world price, while in 1934 it rose to 300 per cent of the world level. Similarly, wheat was quoted at 132 per cent of the world price level in Italy in 1928, and 268 per cent of that level in 1934.

These sharp declines in exports of agricultural commodities have curtailed the purchasing power of countries that produce them, thus in turn reducing their ability to buy manufactured goods. The shortage of foreign exchange has similarly encouraged the establishment of manufacturing plants in agricultural countries which formerly imported such products from abroad, thus furthering the trend toward self-sufficiency. Thus, a vicious circle has been introduced, with industrial countries seeking to make themselves independent of foreign sources of agricultural products, and agricultural nations pushing the development of their own manufacturing enterprises.

The League of Nations experts conclude that this trend has led to the progressive impoverishment of a number of countries that had previously learned to depend on foreign trade to a substantial extent for their prosperity.

The facts and discussion presented in this chapter show that specific acts of governmental regulation and control may be good or bad for the country as a whole, that they may prove to be beneficial to some groups of the population and injurious to others, and that they may be beneficial from a short-run view but disastrous from a long-run viewpoint. These possibilities clearly demonstrate the importance of careful and impartial study on the part of our legislative bodies, before a law providing for regulation or control is enacted. Political expediency should not be substituted for sound economic and social principles and policies.

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Questions for Discussion

1. Why has there been such a decided trend since 1930 toward centralized governmental control over marketing activities?
2. Is a central government in a more advantageous position to plan and control successfully the marketing of agricultural products? natural products? manufactured products? services? Justify your answer in each instance.
3. We hear much talk about unfair trade practices. What is meant by the term? Unfair to whom? How may a business man know whether a particular act of his own firm or of a competitor is unfair?
4. Make a list of acts that have been called unfair by: (a) trade associations; (b) Federal Trade Commission; (c) the courts. What factor has determined the classification in each instance?
5. Why do so many business firms contend that so-called price cutting is unfair? When is price cutting or reduction fair?
6. How do you account for the agitation for a law permitting producers to enter into contracts with merchants in which the latter agree to maintain resale prices? What is the natural attitude of the consumer toward such laws? Why?
7. Are the laws prohibiting quantity discounts "fair" if they result in higher retail prices? Justify your answer.
8. "The legal status of resale price maintenance is still uncertain." Put content into this statement. What efforts are being made to legalize resale price maintenance?
9. How will consumers be affected in those states that tax chain stores so severely that they are driven from the state?
10. Summarize the arguments for and against the general sales tax.
11. We have the Interstate Commerce Commission to regulate the railroads, the Federal Reserve Board to control the banks, the Packers and Stockyards Administration in the Department of Agriculture to regulate interstate commerce in live stock and meat, the Securities Commission to regulate the issuing of securities and trading on stock exchanges, and the Federal Trade Commission to supervise interstate commerce conducted by business concerns in general. What theory of government is back of the establishment of these bodies? Why is the task of the Trade Commission more difficult than that of the other boards?
12. To what extent and in what ways is the buyer protected from the misrepresentations of the seller with reference to the product? What are some of the more frequently used misrepresentations?
13. "That these methods [price cutting on trade-marked goods] are unfair there can be no doubt to those who are familiar with both sides of the question." Do you agree? Justify your answer.
14. What are trade associations? What are their primary functions? How important are they at present? Does their practice violate the principle of "free and unrestricted competition"? Justify your answer. What is their legal status?
15. What services do the open-price associations perform? When do the activities of the associations become illegal?

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16. "As a method of adjusting business disputes, commercial arbitration has three conspicuous advantages over proceedings in the law courts." Do you agree? Justify your answer. What are the three alleged advantages?

17. "The government activities which bear directly on marketing can be conveniently divided into three classes: (1) those which are intended to elevate the plane of competition; (2) those which aim to control monopoly; and (3) those which are planned to promote the technical efficiency of marketing." Explain the significance of each group.

18. "These attempts at governmental control of marketing activities, i.e., the N.I.R.A., the A.A.A., Brazil's control of coffee, England's control of rubber, Chile's control of nitrate, etc., violate fundamental economic principles and are socially unsound." Do you agree? Justify your answer.

19. Do you believe that "self-government of industry" is desirable? Justify your answer.

20. What were the major objectives of the N.I.R.A.? Were they attained? What were the effects of the codes on unfair practices? prices? competition? Why was the N.I.R.A. declared unconstitutional? Why was a unanimous decision so generally unexpected by the public?

Assignment

1. Problem 1, p. 541. Trade-mark Rights.

2. Problem 1; p. 750. Dr. Miles Medical Company v. John D. Park & Sons Company.

3. Problem 2, p. 756. Federal Trade Commission v. Beech-Nut Packing Company.

4. Problem 1, p. 709. Federal Trade Commission v. Mennen Company—Protective Discounts.

CHAPTER XXI

THE PLACE OF EXECUTIVE CONTROL IN MARKETING

Purpose of this chapter: To indicate briefly the importance of information and planning in marketing administration; to survey some of the more important problems encountered in securing the quality and quantity of information necessary, and in devising and executing plans of procedure; to emphasize the need for reliable standards of attainment and methods of testing results secured.

The successful administration of marketing activities demands effective control methods and devices. The executives of a business have to consider two major forms of control, *viz.*, social control and business control. We surveyed briefly, in the preceding chapter, some of the problems encountered when social control appears. The present chapter is confined chiefly to a discussion of business control.¹

Effective administrative control must necessarily depend on the quality and quantity of information available. This information is typically secured through some form of research activity. The effects secured are conditioned by the quality of business judgment and sagacity exercised by the business executives responsible for the formulation of policies, the development of the organization, the construction of a plan, the establishment of standards of performance, and the execution of the marketing program. Marketing research can and should be carried on from two different points of view, *viz.*, the *social* and the *business* viewpoints. An experienced and qualified fact-finding organization is a prerequisite.

Information for Social Control.—The market research carried on from the social point of view will typically be conducted by governmental agencies and endowed foundations. The research based on the business viewpoint will be carried on by the research departments of various types of business enterprises and trade associations.

The research group working from the social point of view attempts to collect, classify, analyze, and interpret that kind of marketing information that has a general or social significance. This group is interested, for example, in such problems as those pertaining to: the efficiency of our marketing organization; the coordination of production and consumption; wastes in marketing; the amount and kind of social control

¹ We mean by "business" control the type of control exercised by the owner of a business who operated within an economic, social, and political system based on private property, individual initiative, and the profit motive.

necessary and desirable to maintain effective and healthy competition, prevent unfair practices, etc.; the number of the various kinds of marketing institutions, the number of members in each class, the economic services that each can perform most effectively, the ratio of one group to another; trends in marketing organizations, policies, methods, and practices; costs; and prices. This group of researchers is particularly interested in the consumer as a buyer. What income does he secure, and is it sufficient? What does he buy, and how does he apportion his expenditures among the various marketing institutions, articles of clothing, food, shelter, travel, savings, luxuries, and services? What are the trends in consumer purchases? How can the consumer be protected against his own ignorance, lack of experience, poor judgment, and the acts of unscrupulous sellers? This group is active in taking censuses of marketing institutions, their kind, number, sales, location, etc., and then making significant analyses of the findings. The reader will readily note that much of the above cited research activity may be of great value to the individual business man. He has, in fact, been active in encouraging the governmental agencies to provide him with these data.

Information for Business Control.—The research groups working from the point of view of the business man are seeking information that will furnish a basis for executive control—the control of merchandise, buying, sales-promotion activities, prices, costs, and public relations. The major problems met by the typical business enterprise fall into two main groups, *viz.*, *external* and *internal*. Some of the problems under the first heading in which the management is vitally interested are: the kind, amount, location, and degree of competition present and in prospect; the present situation, and the trend in social control; the present condition, and the future prospects of business and industrial conditions; the potential demand for the firm's products—who and how many are the prospective buyers, where are they located, how much and how often will they buy, and how and when can they be most effectively contacted; and the problem of public relations.

There are a large number of internal problems, a satisfactory solution of which depends on adequate information. The management can secure valuable information through research to aid in the solution of organization, policy, operation, and control problems. Intelligent planning depends on information secured through market surveys, sales analyses, and other studies. An effective system of records and reports is necessary to furnish information concerning merchandise, customers, sales, collections, prices, and costs. The business executive who is supplied with an adequate system of records and reports, and an experienced and qualified fact-finding organization, can set standards of per-

formance, analyse his sales statistics, conduct reliable market analyses, establish sales quotas, prepare advertising and other budgets, plan sales programs, and constantly check results to determine how well they conform with the established standards. The periodic comparisons of performance with the predetermined standards indicate what action should be taken; that is, should the procedure be changed, or should the standards be revised?

A merchant, for example, buys merchandise for resale. His major objective is to sell these products at a profit. If this objective is to be attained he must buy only goods that his customers need, want, and can pay for. One of his major management tasks is to determine accurately what goods fill this requirement. The buying of staples is comparatively simple; prices and brands are standardized. The major problem is to buy the correct amounts and to maintain adequate stocks. If the merchant buys too much he reduces his profits due to the high cost resulting from the large inventory investment and the slow rate of turnover. If he buys too small an amount he may lose sales because he is "out of stock" when the customer calls. He should plan to buy frequently so as to maintain fresh stocks of merchandise. He may advantageously buy in larger quantities than usual on a rising market, and in somewhat smaller quantities on a falling market. We have learned that it is normally the function of the wholesaler to carry reserve stocks for the retailer. The retailer's function is to supply the consumer with the qualities and quantities of goods wanted at the time and place desired.

The problem of planning the buying and selling of non-staple articles is much more difficult than is the case for staples. The consumer "buys" staples but the merchant and manufacturer must "sell" specialty goods and other non-staples. The merchant must keep records of sales by sizes, colors, materials, styles, quantities, costs, selling prices, mark-downs, complaints, purchase dates, profits, and losses. The manufacturer as well as the merchant finds that he must determine what the consumer wants, and provide it. General Motors Corporation has carried on extensive consumer-research projects in an effort to learn the buyer's wants. This firm found, for example, that when the consumer buys an automobile he wants positive brakes, a car that is easy to operate, sag-proof and rattle-proof doors, more substantial hardware, and non-clash gear shifts. The first ten most important characteristics in a car, according to the answers given in a consumer-research questionnaire, were: first, dependability; second, operating economy; third, safety; and the other seven, in the order of their importance, were comfort, appearance, ease of control, low list price, smoothness, pickup, and speed. The manufacturers of automobiles have met these wants by providing four-wheel brakes, balloon tires, steel frames and tops,

safety glass, and many other improved features not found in a car of the same price class ten years ago.

The Technique of Market Research.—"Market research is the study of all problems dealing with the transfer and sale of goods and services between producer and consumer, involving relationships and adjustments between production and consumption, preparation of commodities for sale, their physical distribution, wholesale and retail merchandising, and financial problems concerned."¹ This important administrative function comprises the collection, analysis, and interpretation of data concerning the market, marketing organization, policies, practices, and procedures. The application of the conclusions arrived at as a result of the research activities is usually considered a separate and distinct function, and should not be confused with the research function. The point of view of the research staff should be that of the true scientist. An unrelenting search for truth, the whole truth, and nothing but the truth should be the guiding principle. Careful checks and tests should be made constantly, to be sure that no false conclusions have been drawn. Research, it should be remembered, is a means to an end and not the end itself.²

The New York Committee on Marketing Research Technique divides the general topic of the technique of market research into a number of stages and steps, as indicated in the following outline.³ This outline indicates the complexity of the technical features of research and suggests the importance of methodology and competent personnel.

THE TECHNIQUE OF MARKETING RESEARCH

Stage I. Preparation—Analysis of problem:

Step A. Define the objectives.

1. Purpose of the study.
2. Scope of the study.

Step B. Determine what facts are required.

1. Facts relating to policies.
2. Facts relating to products.
3. Facts relating to markets.
4. Facts relating to methods and means.

¹ *Market Research Agencies*, source book, Bureau of Foreign and Domestic Commerce. The Market Research Council accepts the following definition: Marketing research is the collection, analysis, interpretation, and evaluation of data relating to (1) a commodity or service and its sales characteristics; (2) all commercial processes through which it passes subsequent to its production; and (3) its actual or potential consumption.

² See also, HARING, ALBERT, "The Evolution of Marketing Research Technique," and FAYLE, D. E., "The Market Research of the Future." Both articles published in *The National Marketing Review*. Winter Issue, 1936.

³ Report of New York Committee on Marketing Research Technique, Ferdinand C. Wheeler, Chairman, *American Marketing Journal*, Vol. I, No. 2, pp. 64 ff., Apr., 1934.

Step C. Determine where facts are to be found.

1. Internal.
 - a. Concrete—Records, preceding studies, etc.
 - b. Abstract—Policies, attitudes, habits, etc.
2. External.
 - a. Groups—Race, sex, age, occupation, etc.
 - b. Areas—Geographical sections, sales district, etc.
 - c. Bibliography—Statistical studies, data, reports, etc.

Step D. Determine how facts are to be found.

1. By direct investigation (records and observation).
2. By multiple personal interviews.
3. By mailed questionnaires.
4. By telephone inquiry.

Stage II. Preparation—Planning of procedure:

Step A. Determine operating plans.

1. Forms—Questionnaire, tabulation forms, work sheets, etc.
2. Staff—Selection, training, routine.
3. Samples—Number, groups, territories, etc.*
4. Testing—Where, when, how.

Step B. Consider costs.

1. Determinable cost.
2. Contingent costs.
3. Continuation costs.
4. Value in relation to cost.
5. Availability of funds.

Step C. Provide for checks on reliability.

1. With similar studies made by others.
2. Questions in schedule to check against each other.
3. With public records—census, A.B.C. reports, phones, autos, homes, etc.
4. Verification of field results.

Stage III. Execution of program—Collection of data:

Part 1—Developed or recorded data.

Step A. By individual effort (routine executive activity*).

1. Data by purchase from other data sources.
2. Data by exchange or solicitation.
3. Data by library research.
4. Data from government sources.
5. Data from media or institution sources.
6. Data by visitation of key sources.
7. Data from client or company sources*.
8. Data from authorities and specialists.

Step B. By group effort (organized activity).

1. Data from multiple unit sources.
2. Data from general field results.
3. Data from collaborative sources.
4. Data from statistical culling.

Part 2—Undeveloped or unrecorded data.

Step A. By individual effort (analytical research).

1. Personal interviews to develop data.
2. Statistical studies.
3. Exploratory or experimental.
4. Estimate and collation.

Step B. By group effort (unit field work).

1. Organization.

- a. Preparation of work sheets, questionnaires, instructions.
- b. Selection and training field personnel.
- c. Mapping, routing, scheduling.

2. Operation.

- a. Preliminary tests of plan and personnel.
- b. Supervision of field work.
- c. Inspection and editing.

Stage IV. Execution of program—organization of data:

Step A. Examine collected data—for relevance, reliability, practicability.

Step B. Classify and arrange—to compile quantitative statistical tables; to summarize qualitative data; to prepare graphic records.

Step C. Analyze data—to determine correlations, trends, and other relationships; to apply statistical adjustments; to develop collateral data.

Step D. Select for final use, according to—object as defined; importance; expedience.

Step E. Provide for report—record of data sources; list of authorities and references; exposition of plan and method of survey.

Stage V. Summation—Interpretation:

Step A. Weigh data, to determine—significance; value of quantitative evidence; value of qualitative evidence.

Step B. Set up tentative conclusions.

1. By study of interrelationship of quantitative and qualitative data.
2. By deductive consideration of data.
3. By intuitive consideration of evidence.

Step C. Test tentative conclusions—by double check of evidence; by examination in the light of common sense; by comparison with alternative possibilities.

Step D. Formulate final conclusions—as called for by specifications; as demanded by conditions disclosed; as needed to reach objectives originally defined.

Stage VI. Summation—Preparation for presentation:

Step A. Confer with interested associates.

1. To conform with expedience and diplomacy.
2. To inform and instruct other advisers.
3. To secure last-minute reactions of importance.

Step B. Revise—rearrange—embellish—index—summarize.

1. In the light of foregoing deliberations.
2. To procure more orderly and logical sequence.
3. For best graphic effects, greatest convenience, etc.

Step C. Determine form and manner of presentation.

1. For personal presentation—reading.
2. Group presentation—in form of address.
3. Enlarged graphic displays—special methods.

Step D. Final review.

1. For conformance with presentation plan agreed upon.
2. For human errors—negligence, misprint of text or figures.

Stage VII. Extension of research service:

Step A. Application.

1. To insure full understanding of the research.
2. To stress the time factor in use of findings.
3. To sustain interest in the application and outcome.

Step B. Continuation.

1. To clear up critical points by additional research.
2. To reinforce thinly documented points.
3. Further to analyze rapidly developing situations.

Step C. Revision—to adjust to new objectives; to conform to new conditions; to incorporate new evidence.

The first step in the handling of any research project is to define clearly and precisely the problem to be considered. What kind and what amount of information is wanted, and why, must be known. The principles of scientific method are violated when information is collected in an aimless and desultory manner. There should be a definite problem to be solved, a theory to be proved, or an assumption to be tested. The subject for study should be limited so that it can be treated adequately. The time, funds, facilities, and opportunities available frequently limit the intensiveness with which a problem can be studied. Information concerning some portions of the problem may be easily secured, while data relating to other aspects of the subject may be secured only after long and careful search, or may not be available at all. These problems, as was indicated above, will probably center around such elements as the product, the demand, competition, and methods of increasing sales and reducing costs. Since market research is much used to reduce waste and decrease marketing costs, care must be taken so as to use it in the proper proportion—not so intensively that diminishing returns are encountered, or so niggardly that inadequate results are obtained.

Finding the Information.—The nature of the objective determines to a considerable extent the location of the information. Much time and cost may be saved by a careful survey to determine what information is already available. There are many published reports of valuable research projects that may be utilized in a given instance to furnish information or to give an idea as to methodology and technique. Universities; advertising and research agencies; newspaper, magazine, and broadcasting companies; governmental departments, bureaus, and commissions; trade associations; endowed foundations; learned societies; and many individuals have published studies, surveys, and analyses, a knowledge of which may serve as a check on one's own efforts, or furnish information not otherwise available. A considerable amount of this type of material may be located by consulting *Reader's Guide to Periodical Literature*, *Industrial Arts Index*, the card catalogue of the Library of Congress, and the local library. A great amount of useful information is often contained and concealed in the files, books, and other records of the individual firm, association, or agency. The older officials of the firm or association may be able to furnish valuable information that has never been recorded.

There is a growing demand for current information which can be secured only at first hand from original sources. The securing of this kind of information requires a specialized form of technique and an experienced and well-trained research organization. This type of information is typically secured through the use of interviewers who follow an outline of questions commonly called a questionnaire. This document may be mailed to the person to be questioned, or the interviewer may talk to him personally or over the telephone.

Methods Used in Securing Information.—There are two major and two minor methods commonly used to secure marketing information. The *interview* and the *mail questionnaire* are the two more frequently used methods, while *observation* and *experiment* are less frequently used.

The *interview* produces more reliable information when the interviewer is intelligent, well trained, and experienced. He can secure in a conversation much valuable information which could never be secured by a questionnaire sent through the mail. The interview method, however, has the disadvantage of being expensive because of the time required and the cost of maintaining a staff of qualified investigators in the field. Quick results over a wide area obviously cannot be secured by this method without an elaborate field organization and great expense.

The *mailed questionnaire* can be sent to a large number of people simultaneously over a wide area at a relatively low cost. Satisfactory replies may be secured if the questions are not too long, if there are not too many of them, if they do not call for confidential information, and if the one questioned feels that the study being made will benefit him, his trade, or business in general. The disadvantage of this method is that people are likely to ignore or misunderstand the questionnaire. This situation may cause the results of the study to show a decided bias.

How Many Are Enough.—Much discussion has arisen as to how many questionnaires or interviews should be used in order to insure satisfactory results. The use of either of these methods of securing marketing information is based on the assumption that a representative sample of the market as a whole will be secured. The mere number of successful interviews obtained is not in itself important; the major problem is to secure enough reliable information to produce a true index of the real situation. Tests that have been made by statisticians and careful students of marketing indicate that the number need not be large, provided *those selected are representative*.¹ There are a number of factors that determine the number of replies necessary. The more important of these are indicated by Dr. Starch in the following quotation:²

¹ WATSON, RICHMOND, "Polling the Consumer," *J. Waller Thompson Bull.*, pp. 12 ff., May, 1930.

² Quoted by Mr. Watson, *op. cit.*, pp. 12 ff.

The number of responses necessary for a reliable set of data depends on the territory that needs to be covered, and upon the number in any community necessary to give a reliable sampling of that community. When the investigation is carried out carefully, it is surprising how small a number of responses are necessary to give an adequate index of the status with regard to any given problem, either in a given community or in the country as a whole.

The number of responses or interviews that are necessary to give reliable representation of the answer to the problem may be determined statistically by ascertaining to what extent the data from various sizes of groups agree or disagree with one another.

The conclusion which seems to be justified by such data as are available is that approximately 50 returns obtained by personal interview, and representing a properly distributed sampling of the class of persons in whom the investigator is interested, is a sufficiently large number to give a fairly reliable index of that community. In the case of larger cities, the number might be extended to 100; and so far as the entire country is concerned, it is highly probable that 6 to 10 typical sections of the country sampled by means of 50 to 100 personal interviews each will, for most purposes, give as reliable a set of data as is ordinarily desirable.

Sales Management asked a number of executives: "How many homes constitute a typical cross section?" The replies are summarized in the following table.

TABLE 86.—OPINIONS OF EXECUTIVES ON HOW MANY ARE ENOUGH¹

Percentage of Those Answering	Percentage of Homes Necessary
28.6	2
20.3	1
16.2	4
13.5	10
9.5	$\frac{1}{2}$ of 1
6.8	3
4.1	5
1.0	$1\frac{1}{2}$

¹ *Sales Management*, pp. 218 f., Sept. 1, 1934.

Thus 28.6 per cent of those answering said that 2 per cent of the homes were enough to furnish a typical cross section; 13.5 per cent thought 10 per cent of the homes should be contacted if a representative sample was to be secured.

A Philadelphia advertising agency executive says:

In our survey work we have in the last several years never set any definite number of calls to be made. We use a sampling method whereby we lay out a minimum number of calls in a definite cross section of the particular community on which we are working. That sample is then charted and the same number is used as a duplicate and charted, and this method continues until the results continue to be of the same proportions. In this manner we feel that we then have

a very definite cross section, and, regardless of how many extra calls are made, the answer would probably be the same.¹

The research director of another advertising agency breaks the problem down into logical groups and says that a national survey should cover 0.1 per cent of the homes, a sectional survey 1 per cent, and a strictly local survey 10 per cent.²

There is obviously no rule or formula that fits any and all circumstances. The facts and conditions of each individual case determine how many interviews are necessary to secure the representative sample necessary to produce reliable results. The objective in mind for one research project may be satisfied with a lesser degree of accuracy than the objective of another project. Thus the question, "How accurately is it necessary to know the result?"³ must be answered in each instance. A representative sample may be secured by taking a *random sample* which must be taken free from the influence of all personal interest or bias, or by the method of *purposive selection*. Mr. Brown says:

The number selected should reflect the total representative population from which the random sample is drawn. If the random sample is to be broken down into sub-classes, then the total number of interviews in each sub-class should be the value for n . In such cases it is assumed that each sub-class has been selected in a random manner. On the other hand, if votes are taken for several objects, then the total n should be for the whole group.

Observation is the method used when the investigator watches and reports what goes on. He may observe, for example, what percentage of people passing a given window stop to look at the window display, note the general appearance of a store, the customers, the town, street, country, and many other factors that tend to reflect market conditions.

The *experimental* method is an attempt to measure the effect of certain causes or factors by controlling the conditions during the experiment. This method has been used with some degree of success in testing the effectiveness of headings for advertisements, size of space used, kind of illustrations, trade-marks and names, and the size, shape, and color of packages.

Analyzing and Interpreting the Data.—The third step in market research is to classify and otherwise arrange in logical order the collected information for the purpose of aiding in determining what it means.

¹ *Sales Management*, op. cit.

² Cf. Brown, T. H., "The Use of Statistical Techniques in Certain Problems of Market Research," *Harvard Bureau of Business Research Studies*, No. 12, May, 1935. See also article by the same author in *The National Marketing Review*. Winter Issue, 1936, pp. 258 ff.

Care should be exercised constantly to prevent any bias, prejudice, or preconceived ideas from influencing the interpretation of the data or the final conclusions drawn. Final judgment should be withheld until all facts are in and due consideration given them, and until the analysis, interpretation, and conclusions have been subjected to various statistical, logical, and other forms of tests. The distinction between fact and opinion, cause and effect, representative and incidental facts must be kept ever in mind. False assumptions and analogies, jumping at conclusions, and trick reasoning have no place in the solution of a problem in marketing.

Performing the Service.—Research should be conducted under the direction of some one who is trained for this type of work and has had wide and successful experience. The successful director of market research should have many of the qualities of the economist, psychologist, statistician, engineer, diplomat, and practical business man.

A firm may have a research organization of its own; it may secure the services of a firm that specializes in this type of work; or allow an advertising agency to perform the service. The following examples suggest how research may be used to increase the efficiency of marketing.

Some Illustrations of the Use of Research. Marketing Policies.—A successful producer or merchant usually gives considerable time and study to the formulation of general rules of performance, or policies, which serve to guide individual action with reference to important recurring problems. Some of the more important marketing policies are established with reference to the characteristics of the product, method of marketing, use of advertising, terms of sale and the amount and quality of services rendered.

The more alert managements, for example, have well-defined policies governing their action with reference to the kinds, types, grades, and qualities of products bought and sold; and as to whether they will buy or produce the goods they handle, or identify and protect them by using brands and trade-marks. The practice of each enterprise expresses its policy or lack of policy.

Producing versus Purchasing.—Some of the factors that influence the determination of a policy are indicated in the following discussion. The final decision of a firm as to the policy it will follow with reference to whether it will manufacture all or a portion of its equipment, materials, and supplies, or buy them from some company specializing in this line of goods, will likely depend upon a number of factors. A few illustrations will serve to make this point clear. A large number of firms use coal; yet few, for obvious reasons, find it advisable to own coal mines.¹ All

¹ Some railroad, steel, and public utility companies, however, find it advisable to control coal mines.

manufacturing firms use lubricating oil, but the relatively small amount used annually and the large amount of capital necessary to produce the varieties of oils needed preclude any, except those specializing in the production of this product, from owning and operating oil wells and refineries. The United States Steel Corporation uses pig iron continuously in large quantities; it finds it profitable to produce the pigs. The small steel firm, however, finds it advisable to buy its supply.

A firm in a new industry might find it advisable to purchase its supplies and materials from independent producers so as to keep down the risk involved in investing large sums in plant and equipment. A number of automobile and truck firms follow this practice. They buy frames, engines, tires, wheels, electrical equipment, bumpers, batteries, and other parts. An old industry that has a steady rate of growth or one that shows no signs of an approaching decline in demand presents less risk than the new and untried industry.

A firm may find it necessary to produce some materials in order to insure a dependable source of supply and to maintain the quality of the finished product. There may be a sales advantage to a machinery manufacturer, for instance, in being able to advertise the fact that he manufactures the entire product. The ability to do this is limited, however, by the financial resources of the company and the managerial and technological knowledge and skill available.

Purchasing of supplies and equipment from outside sources is likely to be advisable when the demand for the buyer's products is uncertain, seasonal, or small-scale; and when the purchased part is relatively unimportant, highly standardized, and easily obtainable.

Policy as to Methods and Practice.—Some firms, after careful investigation, have established a definite policy controlling their use or non-use of middlemen. Others merely follow tradition or the practice of competitors. A number of producers follow the policy of selling direct to the consumer. One group, however, may follow the policy of reaching the consumer by means of its own retail stores; another group may contact the consumer by means of the house-to-house salesmen. Others may use the mail or utilize vending machines, robots, and other forms of automatic selling. Firms that follow a policy of selling through middlemen have to formulate supplementary policies governing the choice of retailers, jobbers, wholesalers, brokers, and other possible agencies.

A large number of firms follow a policy of using no advertising. Those that do make use of this form of sales promotion establish policies governing their advertising practice, such as the preparation of copy and the selection of mediums and appeals.

The established policy with reference to the terms of sale is highly significant. Some retail firms are known as credit stores, and others as

cash and carry. Following 1925, installment selling forced many managements to adopt a definite policy governing time-payment plans. Policies with reference to deliveries and other forms of services, prices, discounts, guarantees, contracts, franchises, and returned goods are frequently found to be essential to effective marketing operation.

To Improve the Product.—A study of the product or service to determine what improvements can be made in its size, shape, color, and other features that will cause it to meet more fully the needs of the buyer usually proves profitable. Valuable information may be secured by interviewing the dealers who sell the product and the buyers who use the goods in order to get their criticisms and suggestions for improvements. The "man who uses one" may be in a better position than the producer to discover the strong and the weak features of the product. Laboratory tests may reveal why a product fails to meet the user's approval. The following quotation shows how research was used by the National Live-stock and Meat Board to aid in the improvement of a particular product:¹

MEASURING PRODUCTION METHODS AND MARKET NEEDS

After organization for research was effected, the first problem to be met was the determination of suitable measuring sticks with which properly to classify and describe the rather complicated data to be secured. It was necessary to find some scale on which the effect of grass or grain feeds, sex, age, degree of fatness, and many methods of handling could be recorded, when their joint result was expressed in the meat carcass. Furthermore, this was only half the problem as similar measurements were requisite to determine the degrees of quality and palatability in the meat after it was cooked or processed according to standards adopted for each kind and cut. Furthermore, any comparisons of a historical nature required some means of taking into account the changes in prevailing ideas on the best kind of meat, its weight, color, and so forth. The research was therefore divided into two parts:

1. Research to produce the most fruitful lines of attacking the problem; and
2. Research applying these lines of attack to experimental animals, their meat carcasses, and their cooked products.

DIFFICULTY OF DEVELOPING METHODS

The development of methods was indeed difficult, for it proved necessary, in final analysis, to devise some method of measuring the sensations of the consumer. At first it seemed possible to measure both tenderness and flavor only on the basis of individual judgment. Hence a large and specially trained grading committee was used by the Department of Agriculture and all of the cooperating state institutions in order to record an average opinion on these two subjects. Try as one might, however, this measure was subject to considerable variation

¹ *Monthly Letter to Animal Husbandmen*, Vol. XI, No. 2, Armour Live-stock Bureau.

and personal opinion. And the great difficulty with which the complete personnel of the committee was assembled, whenever the occasion required, led to variations in the average opinion arising from personal biases that were difficult to adjust. It was therefore determined that laboratory methods must ultimately replace the committee method.

Among the qualities that have been studied are measurement of the degree of tenderness; determination of texture; studies of flavor, color, and juiciness; the effects of various feeds and combinations of feeds on various classes of animals under different conditions; and the influence of sex and breeding on the quality of beef.

Locating the Market.—One of the most common uses of research is to locate the demand, active and potential, for a product. It is estimated that 50 per cent of the counties of the United States contain 82 per cent of the population, 96 per cent of the income-tax returns, 87 per cent of the production, and 96 per cent of the bank deposits.¹ What bearing do these facts and a large number of others have upon the location of profitable markets? Costs of marketing are higher than they would be, in many instances, if producers and merchants knew where their logical markets were, and then developed them through intelligently planned and skillfully executed methods.

The manufacturer and the merchant want to know how much spendable money there is at any given time;² and how this form of purchasing power is distributed—geographically, and otherwise. The Census of Distribution of 1929 and the Census of American Business, 1933, indicate how much was spent during each of these years, by the kinds of business institutions surveyed and for the kinds of goods included. Brookmire Economic Service and a number of other economic services issue forecasts of the estimated income for the semiannual periods. The Department of Commerce publishes in the Survey of Current Business a number of series of economic activities that are useful in determining the amount of spendable income. Sales of department stores, chain stores, mail-order houses, general merchandise rural stores, and of variety stores, published in the Survey, indicate how much is being currently spent. The retail price series published by the Bureau of Labor Statistics indicates the proportionate distribution of consumer expenditures. The family budget studies of the Department of Labor give more specific information concerning the distribution of expenditures

¹ McNIECE, T. M., *Industrial Marketing Ser.*, No. 11, American Management Association.

² *Sales Management*, in "The Survey of Spending Power for 1935," defines spendable money income as "the money received for goods and services produced and rendered during the calendar year plus Federal allotments, and the money paid out of savings and surpluses of business institutions."

by income groups. Employment figures and wage rates, factory production figures,¹ income-tax returns, farm prices and production statistics indicate purchasing power. The sale of new passenger cars is a good indicator of purchasing power. These data are particularly useful because they are available currently in considerable detail. The automobile industry has reliable figures, for example, on the exact number of cars sold by make, style of body, price class, where, and when. This information is available weekly, monthly, and semiannually.

One advertising agency has developed a buying power index.¹ This is secured by combining the three factors—population, number of income-tax returns, and number of retail outlets—without weighting. It is claimed that this index shows a correlation of 0.997 when compared with the actual sales in each of Pennsylvania's sixty-seven counties. This agency has established a buying power index for each county in the country. It is obvious that such an index has certain limitations. Each market has its own individual differences which general indexes will not reflect.

The Trading Area Concept.—Another form of market analysis has attempted to divide the country into trading areas, that is into sections having certain common characteristics of marketing significance. The Department of Commerce, for example, divided the United States into 183 primary trading areas. The factors considered were: transportation, natural boundaries, freight rates, buying habits, trade practices, etc. The International Magazine Company defines a consumer trading area as

an irregular shaped unit of territory based on the flow of retail trade, the boundary lines of which are determined by, (1) the commercial influence of the key city, (2) the physical characteristics of the adjacent territory, (3) the transportation facilities and distribution machinery serving it, and (4) the traditional or regular buying habits and customs of the people.²

Some thirty-three sub-factors are analyzed in an effort to determine the market influence of the key cities. Approximately 641 principal retail trading areas have been identified in the United States by the magazine publisher.

Care must be exercised in using any such plan. There is a different trading area for different kinds of products, and for different kinds and classes of wholesale and retail outlets. The trading area for a retail distributor of staple groceries is very small; the area is slightly larger for drugs, and perhaps somewhat still larger for hardware; many of the

¹ "The BBDO Buying Power Index," by Chester E. Haring, in *Advertising and Selling*, Nov. 9 and 23, 1933.

² MCCARTHY, L. J., director of marketing, International Magazine Company, "Development of Trading Areas," *The National Marketing Review*, Vol. I, No. 1, 1935.

shopping lines, on the other hand, draw from a much larger trading area. Consumers will travel much farther to buy, for instance, dresses, suits, millinery, furniture, and rugs than they will to buy nails, coffee, or tooth paste. Some manufacturers have found that for certain products the country tends to divide into trading areas corresponding to the dominant newspaper circulation. On this basis there are approximately 300 retail trading areas in the United States.

The Bureau of Foreign and Domestic Commerce, in a recent publication, suggests the studies needed by a manufacturer prior to the investing of capital in or the producing and marketing of a new industrial product.¹ This study presents useful information concerning buying habits, competition, market relationships, sources of new industrial product ideas, design, engineering, and production factors.

Selecting Retail Locations.—Retail firms have spent large sums of money and much valuable time in attempts to locate suitable markets. When a firm chooses a location, it has as its major objective the selection of an *opportunity* to reach a market that will produce a satisfactory volume of sales at a reasonably low cost. A good location is one that actively aids the management in making sales at a profit by providing a demand with a suitable degree of accessibility and proximity; prestige for the firm or product; and adequate physical facilities. A given location may be suited to the needs of one kind of business and be altogether undesirable for one of another kind. A given location, in fact, may not be of equal value to two businesses of the same kind if they are of different sizes or cater to different classes of clientele.

Some firms, because of their nature or the policy of the management, need a location in the central business district.² Small department stores, neighborhood banks, and other small retail outlets that find it desirable to be near the homes of their customers tend to locate in outlying business sections. Firms selling shopping goods do better when a number of like kind and quality locate near one another. Businesses handling convenience goods appear to enjoy no particular advantage in locating near others of like kind. Many of these seek streets of dense pedestrian traffic, while others locate on transfer corners and in neighborhood districts.

The answer to the question, Does this particular location afford access to a profitable market? calls for definite standards of: volume of net sales, gross profit, rate of turnover, and rental cost. The ability of any retail firm to meet these standards depends to a considerable extent upon the qualities of the location. The management will likely find it

¹ *Market Research Series*, No. 6.

² Such firms, for instance, as large department stores, banks, brokerage firms, cafeterias, railway- and steamship-ticket offices, large theaters, and hotels.

profitable to establish standards for such factors as rental costs, character of clientele catered to, minimum number of persons or families necessary within a given area, transportation facilities, character and quality of business neighbors, and the volume and quality of pedestrian traffic passing the given location. Having these standards with which to judge any proposed location, a firm is likely to secure a higher percentage of satisfactory locations than if the site is chosen less carefully.¹

A report issued by the Department of Commerce, based on an analysis of the 1930 Census for the metropolitan area of St. Louis, indicates that 53 kinds of stores were not found in the central shopping district, whereas only one of 124 classifications of retail stores was located exclusively in the central district. The 53 comprised principally the food and automotive groups. These have operating expenses generally above the average for those operating throughout the city. The central district had 5 per cent of the city's stores and 36.5 per cent of the retail employees, but accounted for 32 per cent of the retail sales. The average cost ratio of all businesses in the central shopping district was approximately 30 per cent as compared with 27 per cent for the rest of the city. Thirty-seven of 70 different kinds of stores, including department and variety stores and very highly specialized types of businesses, found the central shopping district cheaper on the basis of a percentage of sales; 33 kinds of stores found the central district more costly than outlying districts; this group included women's specialty stores, most eating places, all kinds of clothing stores for men, and shoe stores.

Studying Trends.—The seller needs not only to develop ways and means of determining the *nature* and the *extent* of changes that are taking place in the wants of the users of his goods, their living and working habits and methods, and how they are affected in their thinking, actions, and desires by the changing technological, economic, social, and political conditions; but he must also study the trend of movements that may be regarded as *causes* in order to secure a basis for predicting probable future changes. The producers and merchants who do not foresee the effects of these movements upon the demand for specific industrial and consumer goods will find themselves in the unfortunate position of the bicycle, carriage, and harness manufacturers who did not foresee the effects of the invention of the automobile, truck, and tractor; the manufacturers of phonographs and musical instruments who considered the radio merely a toy; and the textile manufacturers who ignored the coming of rayon and overlooked the consumers' growing interest in fashion.

The trend in the volume of sales and the profits of an industry may be influenced by the rate of growth of population, business, wealth, and

¹ For a fuller discussion of methods and standards, consult an article by the author in the *Harvard Business Review*, pp. 303 ff., April, 1926.

income in that industry's market area. These factors are important because they control purchasing power and the standard of life. During the period 1923-1929, industrial production increased at the average rate of 2.4 per cent annually, and population increased 1.3 per cent yearly; net profits—all corporations—increased at the annual rate of 8.9 per cent; corporate dividends increased 17.2 per cent; the national income grew at the annual rate of 4.9 per cent; new life insurance increased at the average rate of 9.4 per cent a year; while savings deposits increased 8.3 per cent annually.¹ There were decreases, however, in a number of important activities. Permits for new building showed an average yearly decline of 6.3 per cent during the period 1924-1929. Employment in manufacturing industries declined 1.5 per cent annually during the period 1923-1929, while factory payrolls showed an increase of 0.3 per cent annually. Prices declined at the annual rate of 0.9 per cent during the period. The period 1930-1933 was one of rapid decline in income, factory production, construction, dividends, national income, life insurance sales, savings deposits, employment, wages, rents, car loading, and many other factors. From 1933 to the first part of 1936 there has been a rise in all of these divisions.

These figures illustrate some of the conditions that the research department should study so as to be able to furnish information that may be used to answer such questions as, What may we reasonably expect to happen in general to production, profits, income, wages, sales, and costs during the next five-, three-, and one-year periods? How will these conditions probably affect our industry and our firm? This naturally raises the question, What can and should be done about it?

Finding the Relatives in Marketing.—Since all markets, methods, lines of products, middlemen, and salesmen are not of equal importance or value, research may be used to determine the relative value of a large number of marketing elements. The knowledge thus secured paves the way for intelligent selection and elimination. Unprofitable territories can be discarded or methods introduced that will make them profitable; inefficient salesmen can be discovered and the proper action taken; and the degree of effectiveness of the advertising can be established.

Efficient administrative control demands that the management know, for instance, such conditions as the relation of its own sales to the total sales of the industry, the relative position held by each class of customers, and by each model or style of product. The volume of sales of automobiles, to use this product as an illustration, increased uninterruptedly each year from 1902 to 1917. From 1917 to 1930 every third year suffered a decline in sales from the preceding year. The peak in sales

¹ Data from a series of studies published by the Continental Illinois Bank and Trust Company, *The Trend of Business*, May 26, 1930.

was reached in 1929. Beginning with 1930 there was a drastic decline for three consecutive years. The bottom was reached in 1932. Following this, there were three consecutive years, 1933-1935, in which sales increased each year. Each important automobile company knows its relative position in each state, county, and city for each month in the year, and for a number of consecutive years.

The buyers of automobiles are usually divided into three divisions, viz., new and multiple car buyers, replacement buyers, and foreign buyers. The relative importance of each division is easily determined. There was an uninterrupted increase in export sales during the period 1921-1929, although the percentage of total production exported declined slightly in 1929. The percentage going into the foreign market continued to decline through 1934, but increased in 1935. The replacement demand, which now normally absorbs the largest percentage of the total production, increased through the year 1932. The percentage figure jumped spectacularly during the period 1930-1933, and then decreased rather sharply in 1934 and 1935.¹ The number of new and multiple car buyers increased to the year 1923, and showed a declining tendency to 1929; from 1930 to 1932 the decline was most severe. The number of new and multiple car buyers for 1931 and 1932 was reported as zero by the National Automobile Chamber of Commerce; the number reported for 1934 was 442,589.² The relative importance of the three markets is indicated in Table 87.

Since such a large proportion of the families in the United States who can afford a car are supplied with some form of automobile, the opportunity to make sales to the group of non-owners is definitely limited.³ It may be said, in fact, that sales to this class depend largely upon the normal growth in population, increase in per capita purchasing power, reduction in prices, improved quality and performance, the used car market, and partial-payment plans.

Effect of Style on Sales.—The demand for different body types changes rapidly. In 1921 only 22.1 per cent of the cars produced were closed models; by 1925 the percentage had risen to 56.5, while in 1934 approximately 98.8 per cent of the cars were closed models. The once popular touring car accounted for only 0.65 per cent of the 1934 production. The four-door sedan was the most popular body type in 1934, accounting for 42.38 per cent of the total output; the two-door sedan

¹ The Automobile Chamber of Commerce estimates that 2,884,228 cars were "scrapped" in 1930, 2,915,024 in 1931, and 2,000,000 in 1934. The numbers scrapped in 1931, and 1932 were larger than the number of cars produced during those periods.

² *Automobile Facts and Figures*, 1935 ed.

³ There was a car for every 5.8 people in the United States at the beginning of 1935. Nevada ranked first with a car for every 2.92 people, and Alabama was last with a car for every 12.01 people.

was second, accounting for 36.58 per cent of total production. This was an increase from 25.71 per cent in 1931. The coupe was third, with almost 16 per cent of total production. No other body type accounted for as much as 2 per cent of total production in 1934. The roadster, for example, fell from 5.45 per cent in 1931 to 0.57 per cent in 1934. The managements that anticipated these changes in consumers' wants profited;¹ those that did not paid heavily for their lack of foresight.

TABLE 87.—RELATIVE IMPORTANCE OF THE THREE FORMS OF AUTOMOBILE DEMAND¹

Year	Foreign demand including Canada, per cent	Replacement, per cent	New and multiple car buyers, per cent
1921	7.5	28.7	63.8
1922	8.6	30.1	61.3
1923	9.1	21.0	69.9
1924	11.5	30.6	57.9
1925	13.0	37.7	49.3
1926	13.0	40.6	46.6
1927	18.0	57.9	24.1
1928	18.0	54.6	27.4
1929	17.8	49.8	32.4
1930	16.0	82.1	1.8
1931	13.11	86.8	0.0
1932	12.64	87.3	0.0
1933	12.20	84.7	3.0
1934	14.8	69.8	15.4

¹ Computed from *Automobile Facts and Figures*, 1935 ed., Automobile Manufacturers Association

Seasonal Trend.—A large number of industries have to deal with seasonal demand, seasonal production, or both. Farming is greatly influenced by the seasons. Theaters, professional sports, sports in educational institutions, the beverage industry, department stores, summer resorts, urban street railways, and gas and electric companies are some of the businesses and industries that are faced with serious problems brought on because of the seasonal character of the demand. Table 88 indicates the relative monthly sales of automobiles, and suggests how serious the problem may become from the marketing side as well as from the production side. Almost two-thirds of the total sales occur in the middle half of the year, while only about one-sixth of the annual sales are consummated in the last quarter. Less than one twenty-fifth of the annual sales take place in December. People who might otherwise buy in November and December probably wait until the new models are available during the first quarter. The winter season apparently

¹ The outstanding successes of Chrysler and Ford in 1934 and 1935 are good illustrations.

is not conducive to large-volume purchase. Some of this seasonal inequality has been reduced through the introduction of closed cars, heaters, better roads, and more efficient snow-removal service. The plan to hold automobile shows in October and November may stimulate, to some extent, sales during the winter months. The result secured in the first attempt, the autumn of 1935, was highly gratifying. Sales for the first quarter of 1936, however, were apparently somewhat adversely affected.

TABLE 88.—SEASONAL FLUCTUATIONS IN THE SALE OF AUTOMOBILES
Based on a seven-year monthly average, 1927-1933 inclusive.

First quarter		Second quarter		Third quarter		Fourth quarter	
Month	Per cent	Month	Per cent	Month	Per cent	Month	Per cent
January.....	5.99	April.....	11.97	July.....	10.41	October.....	7.22
February....	6.43	May.....	11.98	August.....	9.45	November...	5.00
March.....	9.32	June.....	10.48	September...	7.77	December....	3.98
Total.....	21.74	Total.....	34.43	Total.....	27.63	Total.....	16.20

Wastes in marketing can be materially reduced by a more careful study of the effect of the seasonal factor on selling and then developing ways and means for controlling the operation to the best advantage. The manufacturer should determine, for instance, the normal sales and production for each month, how much stock the dealer and the manufacturer should carry to meet the need, and the rate of flow from the dealer to the buyer and from the manufacturer to the dealer.

Research may be used to find and develop new and more efficient ways of solving the problems arising from the seasonal variations. Some firms have been able to reduce the hazards of seasonal demand by selling two or more products that supplement each other, one being sold during one portion of the year, and the other during the remainder of the period. This method is exemplified by those firms that sell coal in winter and ice in summer. A candy manufacturer whose demand was greatest in winter discovered that the same ingredients used in the candy could be used in a liquid form to pour over ice cream and frozen desserts, for cake icing, and for flavor in malted drinks; bar candy, which sells well in summer, was also introduced. These adjustments secured a continuous demand for the products of the firm.

Research and Marketing Practice.—Costs of selling may be reduced by developing better methods of selecting, training, supervising, and paying salesmen, dealers, and other representatives. Results secured

from expenditures for advertising would probably be more satisfactory if more serious study were given to the selection of mediums, preparation of copy based on sound psychological appeals, and to the scientific testing of these and other elements before a large sum of money is appropriated primarily on faith.

Testing Proposed Action.—Research has been effectively used for pre-testing and post-testing marketing practice. The following methods, for example, are now rather widely used to test the effectiveness of advertising.

1. Keying advertisements and counting the number of inquiries received or the number of coupons returned to indicate the "pulling power" of a particular piece of copy or the coverage of a particular advertising medium.

2. The effectiveness may be tested by the sales results when conditions have been carefully controlled. The degree of effectiveness is indicated by the size of the sales response.

3. Research may be used to test the effectiveness of the various elements of the advertisement, such as size, position, illustration, headline, and time of insertion.

4. Consumer opinions, attitudes, habits, behavior, and beliefs may be determined by research. The laboratory method may prove useful in pre-testing advertising copy. This may take the form of a consumer jury or an order-of-merit ranking. This method, if carefully planned and conscientiously performed, is economical, consumes little time, and furnishes an opportunity to test the various elements of an advertisement separately.

Care must be taken, however, to control the test in such a manner that the results obtained will be reliable. The researcher should always keep the problem clearly in mind, *what is being tested*, and be sure that the procedure followed really tests the attribute contemplated. It is usually desirable to test the test to determine its degree of *reliability*.

An evaluation of the consumer jury method is presented in the following summarized statement.¹

1. The consumer opinion method can be depended upon to give correct rankings of effectiveness of advertisements, if properly conducted.

2. Conversely, blind use of the method, without appreciation of its limitations, might give misleading evidence regarding effectiveness of advertisements.

3. Among the more important requirements in using the method is that of securing an audience really interested in the product advertised, if a dependable ranking of advertisements carrying differing appeals is to be had.

¹ BORDEN, LOVEKIN, EDWARDS, and GRAGG, "A Test of the Consumer Jury Method of Ranking Advertisements," *Harvard Bureau of Business Research Studies*, No. 11, April, 1935.

4. The need of securing an audience really interested in the product indicates an important limitation in the use of the method; namely, it should not be applied to products other than those having general use or interest, unless an effective and economical way of reaching a jury really interested in the product can be devised.

5. If the differences in the advertisements to be ranked relate not to differences of appeal but to such variables as illustration, arrangement of mass, type, and spacing, then dependable results in ranking probably can be secured whether the jury is actively interested in the product or not.

Testing to determine the power of an advertisement to attract attention, arouse interest, secure a reading, etc., is important, but the major objective of the management is to determine the selling effectiveness of a particular advertisement or the value of a given medium, program, or plan. There is little value in testing the obvious, or in trying to convince a person of something he already believes. That is spending time and money in "battering down an open door."¹

The New York section of the American Marketing Society worked out a plan to measure the effectiveness of methods and mediums employed in marketing. The following outline indicates the ideas in general, and the more specific plan for measuring the effectiveness of salesmen.²

I. Measuring the Effectiveness of Methods and Media Employed in Marketing.

A. To study methods of measuring sales effectiveness.

1. Measuring the resultfulness of the entire marketing effort.
2. Comparative measures of efficiency of the several tools contributing to the net result.

a. The methods of measuring the effectiveness of the salesmen.

- (1) Comparative-Results Method, *e.g.*, volume of dollar sales, number of physical units, number and size of accounts opened, percentage of potential accounts sold, growth of sales to number of accounts sold.
- (2) Standard-of-Practice Method, *e.g.*, the methods, technique, and sales helps employed by the most successful salesman in the organization. Each of the other salesmen is then ranked on the basis of this standard of performance. The information is secured by an analysis of the individual records, questionnaires filled out by the salesmen, and reports submitted by an investigator who was present at the time and place of some of the sales interviews.
- (3) Field-Recognition Method, *e.g.*, evaluating the effectiveness of the salesman on the basis of opinions and records of the buyers, the frequency of calls, etc. This information is secured by means of a field survey.

¹ Expression attributed to P. T. Cherington.

² Committee on Industrial Marketing, W. K. Porser, chairman.

- (4) **Functional-Performance Method**, e.g., establishing a set of standards of functions and performance for the salesmen. Score the individual salesman's performance on the basis of the check list, and compare the result with other salesmen's records. This information is secured by an investigator who is present at the sales interview.

Using Research to Determine Store Layout.—The typical retailer, both small- and large-scale, could use research very effectively to improve the layout of his store and the display of his merchandise.¹ *Display* involves the selection of the articles for exhibition and the determination of the time when and the manner in which the merchandise is to be shown. *Layout*, on the other hand, refers to the location and arrangement of merchandise departments, equipment, and office units within the store building.

The Function of Layout.—Layout may be thought of as being both horizontal and vertical. Departments are assigned definite locations vertically when they are placed according to floors in a multiple-floor building, and are located horizontally when given a definite place on any given floor.

There are three major functions performed by layout. It provides *suitable space* for display, demonstration, and examination of merchandise. It may be used to *suggest the quality* of merchandise and services offered for sale. Some layouts convey a bargain atmosphere, while others may suggest dignity, quality, and exclusiveness. The layout, if properly planned, can be used as a very important factor in *reducing sales-force expense* and in increasing sales per salesperson. It has been estimated that in the average store a clerk spends 30 per cent of his time in useless walking from place to place owing to improper arrangement of stock. Some firms have used their unique or unusual forms of layout as subjects for publicity. The word of mouth and published comments get the name of the firm before the public in a favorable manner.

Principles of Layout.—The retail management, in planning and preparing the layout, has as its material for arrangement selling departments, non-selling departments, equipment of various kinds, and a definite amount of space. There are three general guides which may be used in planning the layout. The principle of *convenience*, which has to do with arranging the elements mentioned above so as to furnish as high a degree of convenience to the clientele and personnel as seems practicable under the given set of conditions; the principle of *circulation*, which provides for an arrangement that facilitates the control of the flow of

¹ For a fuller discussion of layout, consult an article by the author, "Standards of Layout for Retail Concerns," *University Journal of Business*, pp. 325 ff., October, 1928.

traffic through the store; and the principle of *coordination*, which guides the management in locating the parts in the most appropriate places after giving due consideration to all factors involved in the particular situation. One of the major tasks of the management is to devise a form of strategy that will make it possible to apply the three principles most effectively after considering the character of the location, the building, the equipment, the merchandise, the clientele, and the objectives of the general sales policies.

Planning the Marketing Activities.—After the management has secured, analyzed, and interpreted the pertinent information that will aid it in forming intelligent decisions concerning policies, products, markets, distribution channels, sales-promotion methods, prices, services, and other important administrative and operative activities, it is in a position to *plan* the marketing program. This plan should cover in some detail the immediate future and in a general way the more remote future. Some firms, for instance, work out their budgets in detail for six- and twelve-month periods. A general plan may be formulated for one, three, five, ten, and even twenty years ahead. It is obvious that these long-range plans are only tentative and are subject to change as conditions and events warrant.

Purpose of Planning.—The marketing plan is based upon the sales forecast which in turn is based on the forecast of general business conditions, the policy of the firm as to sales-promotion activities, the guess as to what competitors may do, and other factors that tend to affect the volume of sales and the amount of profits. The degree of success secured from planning depends upon the accuracy with which all of these factors have been recognized and evaluated, and the skill with which their effect on sales has been anticipated. It may be said, in general, that the purpose of planning in marketing is:

1. To provide for the coordination of the various departments and divisions of the business. That is, to furnish a basis on which to plan the production and delivery schedule, the purchasing activity, the financial and personnel needs, and in other ways promote effective business administration and prevent over- or under-production, periods of depression, and other causes of waste.

2. To provide standards or measuring rods with which to check results. When quotas, standards of costs, profits, and other operating standards have been carefully established, they furnish a basis for placing responsibility and enforcing accountability.

Principles of Planning.—The marketing plan, or program, expresses the objective the management expects to attain. This objective or goal may be expressed in a number of ways. It may be stated, for example, as so many units to be sold each day, week, month, quarter, and year; in terms of the dollar volume of sales for the periods indicated above; in terms of securing a stated number of new buyers and new dealers, or a predetermined percentage of profits, costs, or other suitable terms.

The objective should be regarded as a quantitative factor and as such expressed in numerical terms: The objective to be attained is usually broken down so as to show results according to definite periods of time, and also according to individual salesmen, branches, dealers, territories, products or major lines of products.

The marketing plan should contain much more than a mere statement of *what* is to be done. It should indicate, in addition, *how* the objective is to be accomplished, *who* is responsible for each particular part, *when* and *where* the activities are to be performed, the anticipated cost, and the expected profits. The plan should indicate, for instance, the specific part to be played by salesmen, advertising, mail communication, and dealers. This aspect of planning presents a problem in determining *proportions* and in securing *coordination*. Whether one or all of the above sales-promotional agencies are used, and the extent to which each will be used, depends upon such factors as the character of the product, capital available, volume of business, range of distribution, service requirements, availability of suitable distributors, nature of the demand, custom, policy of the firm, and relative costs.

The marketing program should comprise a sales budget, selling-expense budget, advertising budget, purchasing budget, and budgets for other important sales-promotional activities. The head of each department should be held responsible for the preparation of that portion of the budget dealing with the activities with which he is most familiar and for whose performance he will be held accountable.

Procedure.—Various methods are used by different firms in constructing their sales program. The following procedure serves to illustrate a rather general practice. The individual salesmen, on the basis of their experience and intimate knowledge of their respective territories, estimate their probable sales for the coming year. This estimate may be broken down into months, and by products. These estimates are then turned over to the district or branch manager, if the firm has this type of organization, who combines the estimates of the various salesmen in his district and makes any revisions he finds necessary. The district manager's revision is based on his wider experience and more detailed information as to business conditions and firm policies. The district managers send their estimates to the home office where all estimates are combined, after any necessary revisions based on more extensive information have been made, into the sales budget for the firm. The home office takes into consideration such pertinent factors as production capacity, costs, price policies, competition, financial requirements, seasonal factors, and business conditions.

Some firms follow the practice of constructing a program from the top down which is the reverse of the building-up process outlined above. A

few combine the two methods, using one as a check against the other. A limited number, the more progressive firms, conduct a careful market analysis which shows the sales potentials and the competitive situation; then, knowing the sales effort that is to be expended, the management establishes a quota for each territory.¹ When this method is used, considerable effort sometimes has to be exerted to secure the wholehearted support of the sales force.

The sales program, if it is to be of greatest service as a guide, a schedule of performance, and a check, must take into consideration three major factors, *viz.*, sales possibilities or potentials; contemplated sales effort in the form of salesmen, advertising, dealer helps; and changes in the terms of sale. The budget is of little value unless definite provision is made for its enforcement through an adequate system of records and reports.

The sales plan usually is not, and certainly should not be, considered as absolutely rigid or fixed. If it is found, after the plan has been put into operation, that errors of judgment were made or that unforeseen events have materially changed conditions so that the quotas are impossible, or are too low, adjustment either up or down, as circumstances may warrant, should be made promptly. These changes should be made, however, only by a properly constituted and authorized committee.

Expense budgets should be as carefully constructed, enforced, and adjusted, when necessary, as the sales, purchasing, advertising, and other schedules. The following brief summary of the procedure that might be followed in the construction, revision, enforcement, and adjustment of the sales program serves to illustrate a method that might, with modification, be applied to the other budgets as well.

Construction of the Sales Budget.—The department heads, with the aid of their assistants, prepare estimates of sales for future periods. These estimates are based on a knowledge of the general policies of the business with reference to conditions that affect sales, such as:

1. Changes in methods of making sales, the use of distributors, advertising, and salesmen, class of customers, qualities of merchandise and services, terms of sale, and other pertinent factors.
2. Anticipated market conditions during the period, the agricultural and business outlook, the financial situation, and other factors that affect the purchasing ability of the buyers.
3. Records of past sales and other statistical information that is needed and is available.
4. Information from other departments necessary to permit complementary and supplementary plans.

¹ This quota is usually broken down according to individual salesmen, products, or major lines of merchandise, and by some unit of time, usually a week, month, or quarter.

Combination and Revision.—These departmental estimates are turned over to the marketing manager who revises and combines them into the marketing budget.¹ He may call upon the various division heads to justify their estimates. The revisions, if any, made by the marketing manager are based upon a wider view and knowledge of policies, general plans, and conditions.

Revision and Coordination.—The estimate is now passed along to the budget committee² which views it in its relation to the other major activities of the business. This committee examines the estimates carefully to determine whether the estimated sales are reasonable, whether the costs of securing these sales are excessive, and whether the firm has production capacity and financial resources sufficient to carry out the proposed marketing program. This committee will analyze the various estimates to determine the possible and probable profits during the period.

Enforcement of the Budget.—After the plan has been revised, accepted, and finally put into operation it becomes necessary to determine how well it is being followed. Records of all activities are made, summarized, analyzed, and reported. Such reports as the following serve to illustrate this phase of the plan. A report comparing actual sales and estimated sales of each item should be prepared by the comptroller's office each month or for other predetermined periods. Reports showing the condition of inventories, rate of stock turn, relation between purchases and sales, selling expense and net profits, by departments, should be prepared by the accounting department. An analysis of sales showing volume by terms of sale, method or agency, territory, sizes, models, and so on is sometimes necessary for the effective execution of the plan.

Adjusting the Budget.—There is no necessity for adjustment of the estimates so long as the reports show that the actual sales are closely in line with those anticipated. If the comparisons show a marked divergence, some kind of action is necessary. The cause of the lack of conformity must be determined; the marketing executive should be asked to explain. If the cause is due to ineffective operation, pressure will be exerted to secure better results.³ If the cause is outside the sales department, the source must be found. It may be due to the failure of the production department or of some other division of the business to meet its schedule. If the cause arises out of the general business situation or other conditions over which the firm has no control, then the program must be adjusted so as to take the new factors into consideration. The

¹ Each department should, at the same time, prepare an expense budget, which is revised, coordinated, and enforced in a similar manner.

² The budget committee may comprise the president, treasurer, comptroller or auditor, production manager, and marketing manager.

budget committee secures all the available information and revises the budget which as revised now becomes the operating plan for the future.

One of the most valuable features of the planned system of marketing is that it brings immediately to the attention of the management inefficiencies and wastes that might otherwise not come to its attention before it is too late to take remedial action. Market research, forecasting, and planning obviously cannot increase sales generally during a period of serious industrial depression; they cannot put purchasing power into the consumers' pockets; they should, however, warn the management in time to adjust its activities and thus reduce losses and make the best of unfavorable conditions.

The following outline summarizes in a series of steps the procedure that has been found useful, in certain instances, in planning the sales program from a profit viewpoint.

SECURING INCOME FROM SALES¹

1. Demand and the consumer viewpoint will be the keystones;
2. The volume in our industry and the relation of our volume to it will be determined;
3. Past history, present trends, opinion of sales manager, and views of salesmen will be fully considered;
4. A market analysis will be entrusted to the sales engineer;
5. Turnovers of plant, inventory and capital employed, both actual and desirable, will be calculated;
6. Pertinent financial relationships will be ratioed;
7. Buying capacity of our trade, by territories, will be developed;
8. Profitability of lines will be determined;
9. The matter of adding new lines and dropping old ones will be studied;
10. The sales dollar will be broken down into its component parts for a period of years past, to develop trends;
11. System in use for compensating salesmen will be analyzed in an effort to develop the most modern form of salesmen's incentives;
12. A forecast of sales income for the ensuing year will be developed, with quotas established according to lines, and by salesmen and territories;
13. Sales trips will be planned in advance for salesmen;
14. Expense allowances will be established for salesmen;
15. Charts and statistics will be maintained in order that we may keep in touch with progress and results in this great work of securing the needed volume of sales.

The major points of this discussion may be summarized by saying that research secures, analyzes, and interprets those pertinent facts which indicate *what* and *when* to purchase and sell, *how much* should be purchased, or can be sold, *to whom* it can be sold, and *ways* and *means* of buying and selling. Research furnishes a basis for *establishing standards*

¹ KNOEPFEL, C. E., "Profit Planning and Control," published in *Factory and Industrial Management*.

with which to test the effectiveness of policies, organizations, and methods. The cumulative result should be lower marketing costs, reduced prices to the consumer, increased volume of sales, and a more satisfactory net profit to the producer and to the merchant.

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Questions for Discussion

1. Formulate a definition for each of the following: (a) marketing research; (b) market research; (c) sales analysis; (d) planning; (e) budget.

2. Distinguish between research as a basis for "social control" and that for "business control."

3. How does long-term planning differ from short-term planning as to: objective, point of view, and technique?

4. Give examples that illustrate the use of research in securing information to aid in the formulation of marketing policies; determining the location of a market; the potentials of a given market area; the effectiveness of a form of advertising or other sales-promotion device.

5. List a number of research projects that might be useful to a buyer: in a large department store; a large manufacturing plant selling industrial equipment; a large manufacturing plant selling consumer goods.

6. List a number of research projects that might be useful to the advertising manager of: an automobile manufacturer; a manufacturer of breakfast food; a manufacturer of mechanical refrigerators.

7. Outline in a general way the type of information needed by the marketing manager of a manufacturer of domestic air-conditioning equipment in planning his activities for the coming year.

8. List some of the major difficulties met in planning marketing activities in any given instance.

9. What are the general principles that should be followed in conducting a piece of marketing research? Summarize the advantages and the disadvantages of: (a) the personal interview; (b) the mailed questionnaire. What is meant by the term "representative sample"? How may such a sample be secured?

10. What is meant by the term "theory of probability"? What is the difference between *a priori* probabilities and *a posteriori* probabilities?

11. Indicate the application of the theory of probability to some marketing problem.

12. "The ideal situation from the point of view of economy in distribution would be one represented by a perfectly even climate, perfectly constant production of all essential staples, and, presumably, an unvarying density and vigor of consumption." Outline the actual situation.

13. "Clothing manufacturer competes with clothing manufacturer, but the clothing industry as a whole is engaged in competing with all the automobile, the radio, and the furniture industries." Is this situation new or unusual? How does it affect the problem of control?

14. "The essential features of retail equipment are of course comparatively simple, but only in rare instances do they exist in simple form." Illustrate the complexities that exist in connection with retail equipment. How do you account for this situation? How does it affect marketing problems and costs? How may research and planning be used in solving the problems?

15. "Good management can be defined as the wise use of coordinated knowledge." Interpret this statement in terms of what you have learned in the present chapter.

Assignment

1. Problem 1, p. 591. Hanover Cotton Mills—Securing Information.
2. Problem 1, p. 52. Siegel Company—Location, Sales Estimates.
3. Problem 1, p. 499. Rolland Department Store—Sales Estimates, Financing.
4. Problem 1, p. 133. Tuscarora Company—Sales Control, Customers' records.

CHAPTER XXII

STANDARDS OF MARKETING ACCOMPLISHMENT

Purpose of this chapter: To examine some of the criticisms that have been directed at marketing organizations, policies, and practices; to discover why the costs of performing the marketing process consume such a large proportion of the buyer's dollar; to note the trend in these costs; to discuss the importance of standards of accomplishment as devices for the promotion of a higher degree of marketing efficiency.

On the basis of the information secured in the study of the first twenty-one chapters of this book, what conclusions does the reader draw concerning the degree of efficiency attained with our marketing machine? Is it, on the whole, less efficient than our producing machine? How do you know? Are parts of the marketing system highly efficient, and other parts woefully inefficient and obsolete? How do you know?

Criticism of Our Marketing Machine.—The amount of criticism that has been directed against our marketing organizations, methods, and policies might lead one to believe that the entire marketing process is performed in a hopelessly inefficient manner. Much of the criticism is destructive in nature, sensational in character, and is usually made by people who do not understand the complex conditions that determine marketing practice. There has been, however, some constructive criticism based upon knowledge and understanding of the problems. It is this type of protest that is likely to produce the desired results by centering attention upon the weak spots and by offering *methods* for analyzing the problems, and for developing and testing possible solutions.

The form of censure seems to vary somewhat with general business conditions. Thus when there is a seller's market, such as existed from 1918 to 1921, criticism comes largely from the individual consumer, labor unions, politicians, and reformers; in a buyer's market, such as arrived after the deflations of 1921 and 1930-1932, complaint comes largely from producers, especially the agrarian groups, and certain manufacturers who desire protection in the home market through tariffs and other government aids. The small retailer joins in the protest during a buyer's market because he finds it more difficult during such periods to meet the competition of other forms of retailing, such as the house-to-house canvasser, department store, mail-order house, and the chain store. The demand for government aid reached the climax in

1933, when, at the insistence of certain business groups and of the farmers, the government sponsored the N.I.R.A. and the A.A.A. plans. Consumer committees were organized throughout the country. These organizations criticized the forms of advertising used, the methods of marketing employed, and the quality of merchandise offered for sale. They were vociferous in their demands for grading and grade labeling, for reduced costs of marketing, and for lower prices of many food products, clothing, and utility services.

The Kinds of Criticism.—The general marketing system has been attacked on the ground that the *costs* of selling goods and getting them into the hands of the consumer are too high. This criticism is most prominent during a seller's market. It has been said that there are too many different *kinds* of middlemen.¹ These critics would bring about direct marketing where possible by eliminating one or more of the commonly used middlemen. The assumption is that each of these agencies adds to the cost of marketing and that its elimination would reduce costs and prices. Some critics say that there may not be more of the above-mentioned *kinds* of functionaries between producer and consumer than are needed, but there are more units of each kind than are necessary; thus while wholesalers and retailers are necessary, there are at present too many in each group, and some should be eliminated. This would increase the volume of sales for each remaining dealer and tend to reduce unit costs and prices.

Retailers and wholesalers have been accused of *inefficiency* in buying, advertising, selling, financing, and in the performance of other activities of their businesses. Organized exchanges have been called gambling devices which fix prices against the best interests of the producers and the consumers, and to the advantage of the brokers, commission agents, and professional traders.

Another group of criticisms has been directed toward the inefficiencies found in the marketing of particular products. It is contended, for instance, that too large a proportion of the retail selling price goes to middlemen, and to transportation, storage, and financing agencies, and not enough to the producers of fruits and vegetables, grains, and live stock. It has been charged at the same time that the consumer is paying too much for these products.

There are, it is alleged, inefficiencies in the marketing of certain manufactured products due to *monopolistic control*. The argument is that because of its monopolistic position the firm is not forced through

¹ The government of Panama, for example, has limited the number of retail stores that are permitted to operate. Beginning July 1, 1935, some 750 stores which had been designated as "surplus" were either to liquidate or to pay a confiscatory tax. *Domestic Commerce*, July 10, 1935.

competition to institute efficient methods of marketing; consequently, the public pays an excessive price.

Criticism is directed likewise against the methods used and the high costs of performing certain services while developing a demand for the product and in getting the commodity to market. In other words it is believed that there is too much competition in the marketing of some goods. Thus the character of sales-promotional activities, transportation and delivery services, cold-storage and warehouse facilities used together with the lack of dependable standards are deemed responsible for the excessive costs, high prices, and low profits.

Irving S. Paull contends that the wastefulness of present methods and practices of marketing absorbs considerably more than the amount necessary to pay liberal dividends.¹ Industry, while constantly striving to find economies of production, too frequently loses the fruit of manufacturing economy in extravagant costs of marketing. The earnings and savings secured through better production technique can be realized and maintained only through the sale of the output. The proper recognition of the functions of marketing and the cost factors that attend their performance is the beginning to a better condition. The manufacturer cannot eliminate any cost factor pertaining to his function of marketing. Good management, however, according to Mr. Paull, may modify various items of cost by establishing more effective control. Many items may seem negligible or appear justified as a matter of habit; nevertheless, in the aggregate they too frequently represent an extravagance of selling.

A large volume of criticism has been directed toward huge expenditures for sales promotion and the questionable methods used. It is claimed that people are being inveigled into making ill-advised purchases, and into paying prices higher than are warranted. A general belief exists that there is widespread inefficiency in management due to ignorance of proper merchandising procedure and to the lack of dependable standards of goods, of procedure, and of attainment.

The Costs of Marketing.—According to the estimates of Galbraith and Black,² the total costs of marketing for 1929 amounted to \$24,380,000,000. For each dollar spent on the manufacture of goods an outlay of 85 cents for marketing all commodities, manufactured and others, was made. Table 89 presents in itemized form their estimates for retail, wholesale, and manufacturer's marketing costs.

The estimated costs here presented are certainly too low for the total costs of marketing. The estimates do not include the costs of selling

¹ President, Chain Institute—from a brochure, *Distribution of Consumer's Goods*.

² "The Quantitative Position of Marketing in the United States," *Quarterly Journal of Economics*, May, 1935.

the great volume of personal, professional, and many other forms of services; the marketing costs of the farmer are not computed; the costs of marketing the unmanufactured forest, fishery,¹ and mineral products by the original producers are likewise omitted.¹ Very little reliable information is available upon which to base an accurate estimate of these costs. They are, however, quite substantial and must be borne by some one. Normally they are covered by the price paid by the ultimate buyer; in many individual instances they are absorbed by the original seller in the form of a lower net price received.

TABLE 89.—COSTS OF MARKETING

Retailing costs.....		\$13,750,000,000
Total payroll.....	\$5,190,000,000	
Proprietors at full-time salary rate.....	1,820,000,000	
All other expenses, including interest where actually paid.....	5,180,000,000	
Interest and profits (residual).....	1,560,000,000	
Wholesaling costs.....		6,990,000,000
Salaries and wages.....	3,010,000,000	
Other expenses (including interest actually paid and rent actually paid).....	3,130,000,000	
Dividends.....	200,000,000	
Withdrawals of individual entrepreneurs.....	580,000,000	
Corporate savings.....	20,000,000	
Business savings of individuals.....	50,000,000	
Manufacturer's marketing costs.....		3,640,000,000
Costs of sales to retailers and home consumers.....	1,530,000,000	
Costs of sales to wholesalers and industrial consumers.....	2,000,000,000	
Marketing costs incurred by manufacturers on goods transferred to wholesale and retail branches.....	110,000,000	

Conditions under Which Modern Marketing Takes Place.—It is evident that our marketing system is faulty in many respects and that its critics have a sound basis for some of their charges. We should, however, bear in mind while criticizing that we are living in an economic organization based upon private ownership of property and upon a substantial degree of competition. The nature of modern methods of production and of living cannot be overlooked. The marketing policies, organizations, methods, and practices are conditioned by large-scale methods of production and by specialized producing units; by the

¹L. D. H. Weld makes the following estimate for 1929: retail costs, about \$13,000,000,000; wholesale costs, about \$6,000,000,000; transportation costs, about \$4,000,000,000; and manufacturer's costs, about \$4,000,000,000. *Bull. of the Taylor Society*, Vol. XVIII, No. 2, pp. 26 ff., April, 1933.

characteristic features of geographic areas; by the concentration of large numbers of people in cities far removed from the places of production; by the desire of buyers for variety, which can be met only through the collection of goods from widely scattered districts, *e.g.*, oriental rugs, tropical fruits, tea, coffee, imported jewelry, furniture, clothing, and works of art; and by the passionate desire of many people to have only that which is at the height of fashion. These conditions explain, although they do not excuse, many of the so-called inefficiencies of market practice. The type of goods and services being called for by the consumer of today cannot be delivered to him at costs comparable to those incurred when people satisfied their needs from near-by sources and did not expect elaborate and expensive services. The savings enjoyed through greatly improved production methods and processes are sometimes used up in the growing costs of marketing. Some increase in the costs of marketing is inevitable under present conditions of living. How much of this increase is justifiable should be the question at issue.

The following statement expresses a sane view concerning this problem.

There is waste, of course, in the use of the various instrumentalities of marketing, *e.g.*, in the utilization of advertising, salesmen, mail communication, distributors, and in the methods used. One would have to search long and diligently before a machine, organization, institution, or system were found that operated at 100 per cent efficiency. The automobile, the steam engine, and many other scientifically developed contrivances are far from 100 per cent performance. Does any reasonable individual suggest that these machines be demolished and the use thereof ceased because of the failure to reach perfection? The answer is obviously no. Attempts at improvement are constantly being made. The marketing machine should be considered as dispassionately and as tolerantly as the machines in the physical and chemical world. There is ample evidence that improvements are being made.¹

Why Costs of Marketing Are Increasing.—That part of the increase in the costs of marketing which is due to the character of our general economic system and to the methods of modern living is inevitable and should not be objected to by the consumer, the merchant, or the producer. As long as people demand a wide variety of goods delivered to them just *when, where, and in the condition* they may happen to fancy, they must expect to pay for the service. It should be obvious that some kind of system or organization comprising a part or all of the following—retailers, wholesalers, brokers, commission agents, auctions, and exchanges; and transportation, storage, and finance companies—is necessary to perform the essential marketing services.

¹ TIPPER, HARRY, *Printers' Ink Weekly*, pp. 74 ff., Oct. 18, 1934.

Need of Effective Management.—That part of the increase in the cost of marketing due to poor management is not necessarily inevitable, and may be reduced, if not entirely eliminated. It has been said that two-thirds of the retail failures are due to two causes, incompetence on the part of independent retailers, and lack of capital. Incompetence in marketing can be reduced only by the introduction of a higher grade of management. Executives and prospective managers must be willing to spend the time necessary to collect the facts needed to establish dependable standards of performance and learn to apply the fundamental principles of marketing and administration.

What Standards Are Needed?—Standards should be determined and classified so as to be useful in testing the degree of efficiency attained by the various elements comprising our marketing organization. We want to know, for instance, the degree of efficiency with which the following marketing functionaries perform certain parts of the marketing process:

1. The manufacturer, the farmer, and other types of producers.
2. The various kinds and types of wholesalers.
3. The various kinds of retailers.
4. Auctions and exchanges of various kinds.
5. Other marketing agencies, such as brokers, commission men, and advertising agencies.
6. Those functional agencies whose efficient operation is so vital to successful marketing, such as transportation, finance, insurance, and warehouse firms.

Standards that will aid in determining the efficiency with which individual units in each of the above listed groups operate are needed. These criteria would aid the managements in measuring the effectiveness of their marketing policies, methods, and organizations. These standards should furnish a measuring stick to gauge the work of the sales force, agents, and the various other forms of sales-promotional agencies; to judge the relative profitableness of a given customer, an order, a district, or a location; and to determine the relative value of the different methods of buying and selling.

Some Important Standards of Performance.—No attempt is made at this point to list all the possible standards that might be of assistance in evaluating the various types of marketing institutions and the diverse methods in use. There are some standards, however, that have a wide application under a normal set of conditions. Each institution, or method, on the other hand, has certain peculiarities which make the establishment of special standards necessary. Among the more fundamental criteria of performance are figures expressing net sales, costs of merchandise sold, gross margin, mark-up, total marketing expenses, net profits, and rate of stock turn.

Net sales, one of the most commonly used standards of sales performance, equals gross sales minus returns. The figure representing

net sales furnishes a basis for stating the cost of goods, gross margin, total selling expenses, and net profit; that is, net sales is quoted as 100 per cent, and cost of merchandise is reported as a percentage of this base.¹ Thus gross sales might equal 110 per cent, returns 10 per cent and *net sales* 100 per cent.

The effectiveness of the sales personnel, advertising, and other sales-promotional devices, of methods, and of policies is reflected in the amount of net sales. The net sales figure, as a standard, will vary according to a number of factors. Thus the volume of sales is influenced by such factors as the kind, size, and location of the business; the kind and quality of product; the policy of the firm as to prices and methods of payment; the kind and amount of services given and sales-promotion activity employed; and the general and specific economic and social conditions that affect purchasing power and willingness to buy. The net sales figure furnishes a valuable basis for comparing the effectiveness of the marketing activities of firms of like kind, quality, size, and location, which operate under similar policies and conditions. The net sales figure alone does not, of course, necessarily indicate the degree of financial success of the particular firm. This figure, taken by itself, might suggest that a given firm is quite efficiently managed, but when the entire operation is analyzed one might find that the large sales were due to fortuitous circumstances instead of good management, or due to excessive costs.

Cost of goods sold includes all expenditures for merchandise, and is determined by adding the total cost of goods bought during the period of time under consideration to the value of the stock of inventory on hand at the beginning of the period; and then subtracting from this total the sum of the value, at cost, of the inventory at the end of the period, the amount of the allowances and discounts received on purchases, and the value, at cost, of any goods given to employees or used by the owners of the business. The figure is usually expressed as a percentage of net sales. This percentage reflects the effectiveness of the purchasing plan. A relatively low figure indicates good buying connections and procedure.

Gross margin, sometimes called gross profit, is the difference between *net sales* and the *cost of goods sold*. This figure also is stated as a percentage of net sales. Thus net sales always equals 100 per cent, so the cost of goods sold plus the gross margin always equals 100 per cent.² The lower the figure for cost of goods, the higher will be the gross margin.

¹ This is according to the new form approved by the Board of Directors of the National Retail Dry-goods Association May 14, 1935, and also by the Securities and Exchange Commission as meeting their requirement.

² The gross margin percentage is determined by dividing the product of the gross margin in dollars multiplied by 100, by the net sales stated in dollars. Thus if the net sales are \$1,000 and the gross margin is \$300, $300 \times 100 \div 1,000 = 30$; that is, the percentage of gross margin to net sales is 30 per cent.

from which total expenses and profit are paid. The gross margin figure also reflects the effectiveness of the buying plan. It indicates, in addition, possibilities for profit, which in turn reflect the degree of effectiveness of the general merchandising and management policies.

Mark-up is distinguished from gross margin in that it is the difference between the *indicated* selling price and the *cost* of merchandise bought.¹ Thus the mark-up, stated in cents or dollars rather than in percentages, represents the gross margin that is *hoped for*, while gross margin, as defined, represents *actual* realization.² *Mark-down* is the reduction in the marked price which is made to stimulate sales and to dispose of certain articles of merchandise within a given time limit. It quite frequently happens that the management misjudges the demand for certain goods. This situation may arise from a number of causes: thus the buyer or manufacturer may not know the needs and desires of his market; he may buy too much, at the wrong time, or the wrong quality and style; or the weather, poor crops, and unemployment may reduce the purchasing power of the prospective buyers and, consequently, sales. Under these conditions mark-downs may be necessary to move the merchandise. A large number of mark-downs usually indicate poor merchandising ability.

Total marketing expenses comprise expenditures for such items as salaries, wages, rent, advertising, wrappings, repairs, depreciation, refrigeration, light and power, laundry, telephone and telegraph, warehousing, insurance, taxes, delivery, collection, and traveling expenses, and any other expenditures connected with the marketing of the goods or services.³ This item does not include the cost of merchandise.⁴

¹ "Merchants assume that the percentages of margin and mark-up are the same. This confusion is not strange because margin and mark-up in dollars are identical. The percentages, however, are different. Both represent the difference between cost of merchandise and selling price. Margin is a percentage of sales; mark-up is a percentage of cost of merchandise." From *Better Retailing*, 9th ed., published by Merchants' Service, The National Cash Register Company.

² The Harvard Bureau of Business Research uses the following formula for computing initial mark-up:

$$\text{Initial mark-up equals } \frac{\text{Gross margin plus Alteration and Workroom Costs plus Total Retail Reductions minus Cash Discount Received}}{100 \text{ plus Total Retail Reductions}}$$

³ Expenses are usually classified under one of two headings, and sometimes both are used; e.g., the so-called Natural Base—salaries and wages, tenancy costs, light, heat, water, and power; depreciation of improvements, fixtures, and equipment; communication; traveling; supplies; advertising; insurance; taxes; unclassified; and interest. The other heading is the Functional Base—"store" expense; transportation expense; administrative expense; general expense; and all other expense. Cf. *Harvard Bureau of Business Research, Bull.*, No. 94. See also p. 746 of this book.

⁴ The new form used by the National Retail Dry-goods Association uses the term

The item *salaries and wages* should include an amount for the services of the owner of a retail business, if he is active in the management of the business, and for the members of his family who aid in the marketing activity, whether the sum is actually paid or not.

Rent on the property of the owner used for marketing purposes, as well as depreciation on all fixtures and equipment, should be included in the expense item. Interest on capital of the owner used in the business should be charged to the expense account. Unless these items of wages, rent, and interest are included in all cases, the management will not be able to compare its operating results with those of other firms which do include such items in their reports.

The figure representing total expense is usually stated as a percentage of net sales and reflects the efficiency of operation.¹ Individual items—for instance, rent, wages, and delivery expense—may be compared with similar items of other firms operating under comparable conditions, to determine whether the business is spending more than the “average,” “representative,” “common,” or other “standard” firm.

Net profit is the difference between gross margin and total expense. This figure represents the earnings of the business. The net profit is expressed also as a percentage of net sales, and shows whether the business, the product, the store, the sales territory, the management, or whatever is being tested or measured, is satisfactory.

The *rate of stock turn* is the number of times the stock of goods is sold and replaced during a given period of time. The unit of time generally taken is one year. The ideal way to calculate the rate of stock turn is on a physical-unit basis. Thus if a retailer bought fifty dozen pairs of shoes and sold all of them in three months he has had a complete turn of stock at the rate of four times a year. When a wholesaler or a retailer has in stock several thousand items of various kinds, sizes, colors, qualities, and prices, it may be impracticable to attempt to calculate stock turn on the physical-unit basis. The rate, consequently, is usually determined on a monetary basis. This may be done in either of two ways: (1) divide the total *cost of goods sold* during the year by the *average inventory, at cost*, for the same period; or (2) divide total *net sales* for the period by the *average inventory taken at the selling price*. Care

total costs which does include the cost of merchandise. The term gross margin is not used. Thus merchandise costs plus work room, occupancy, buying, publicity, and operating costs—i.e., administrative, selling, and delivery—equals total costs. This combined total is subtracted from net sales and the remainder indicates the net profit or loss.

¹ The expense percentage is determined by multiplying the amount of expense in dollars by 100, and then dividing this product by the amount of the net sales. Thus if the expenses are \$300 and the net sales are \$1,000, the expense percentage equals $200 \times 100 \div 1,000$, which is 20.

should be taken in determining the average inventory. A fairly satisfactory method is to divide the sum of the inventories taken as of Jan. 1, Jan. 31, and for each of the succeeding months of the year, as of the last day of the month, by thirteen. Average inventories, determined by dividing the sum of the inventories at the beginning and the end of the year by two, do not usually reflect the true situation.

A relatively low rate of stock turn generally indicates poor management. The unsatisfactory rate may be due either to poor buying or to poor selling.¹ A very high rate of stock turn does not necessarily indicate good management. Unless each turn is being made at a satisfactory net profit, the business may be losing money very rapidly because of the high rate of stock turn. If the high rate of stock turn is secured at great cost or by extreme mark-downs it does not reflect good management. In such instances the high rate of stock turn becomes an index of inefficient management. Studies of the relationship between the rate of stock turn and profits seem to indicate that at different points turnover influences profits in varying degrees. Thus profits tend to increase with turnover only up to a certain point; beyond that point, "the optimum point," any further increase in turnover will result in an actual decline in profits.²

A high rate of stock turn, within certain limits, reduces the costs of marketing by making the same amount of capital produce more sales. The same or larger volume of sales is attained with a lower inventory, rent, interest, and insurance cost. Loss from frequent and large mark-downs is reduced because the risks of style changes and physical deterioration are less. This increased rate of stock turn may be secured in a profitable and economical way through being careful to produce or purchase only what is wanted by the consumer in the amount, at the time, and of the qualities, sizes, styles, and colors he desires, and in the price ranges he is willing to pay. Slow-moving, obsolete, damaged, and otherwise unwanted goods should be closed out promptly and their places taken by fresh merchandise that will sell promptly at a reasonable profit.

The average rate of turnover in the wholesale dry-goods field is about 3.4 times a year, or once every 107 days; in the department-store field, 2.1 times or once every 174 days. Thus it requires, on the average, 281 days for dry goods to pass through the wholesale and retail outlets

¹ The National Cash Register Company, in its *Handbook for Merchants*, lists the following causes of slow stock turn: buying too much at a time; lure of large discounts for big quantities; seasonal changes; too many brands; buying from too many sources; too many end-sizes; wrong colors, materials, etc.; wrong prices or too many prices; failure to take frequent physical inventory; obsolete styles; shopworn articles; uninterested and untrained salespeople; lack of salespeople's knowledge of stock; lack of proper stock control records; and failure to find out what customers want.

² GILMAN, J. M., *The Journal of Retailing*, Vol. IV, No. 3, p. 18.

to the consumer. The rate of turnover for the chain dry-goods store, on the other hand, is 4.3 times a year, or slightly less than once every 85 days. The tobacco chain store secures 50 stock turns a year, while the independent tobacco store secures only 5; meat markets enjoy a stock turn of 57.4 times, jewelry stores average only 0.9 times a year; chain drugstores have a stock turn of 13.7 times, while independent drugstores average only 2.7 times. These figures illustrate the differences in rates of turnover arising from differences in the nature of the demand for different commodities and different managerial policies. Every type of business seems to have its own characteristic rate of stock turn.

Stock Control.—Another aspect of efficient marketing is the control of merchandise. This managerial activity begins with purchasing and ordering merchandise, supplies, and raw materials, and continues until they have been received, passed through the factory or store, and delivered to the final user. The function of control of materials and merchandise is worked out by means of policies, organizations, and procedures including adequate records and reports. The following summary indicates the nature of the information that must be considered if satisfactory control is to be attained: when and how much to order; the size and condition of stocks on hand; what the mark-up and mark-down figures show; the rate of stock turn; how the business is affected by hand-to-mouth buying; the amount of merchandise returns, and the reasons for these returns; the possibilities of benefits from simplification and standardization of stock; what lines show the most satisfactory profits, and what ones the least.

The Purpose of a System of Stock Control.—The primary objective of a system of stock control is to provide the firm with a *balanced stock of merchandise* at all times. The ideal inventory should contain a complete assortment of merchandise in quantities, styles, price lines, colors, and sizes proportionate to the demand. The stock should be neither so large as to materially reduce the normally expected rate of turnover, nor so varied that a large number of brands, sizes, styles, models, and the like secure only an occasional sale and thus lead to loss through deterioration and slow turnover. The size and variety of stock, on the other hand, should not be so limited as to be inadequate to meet the expected volume of sales.

The Use of Sales Records.—The sales records of the firm constitute a valuable source of information that should be utilized in determining *what, when, and how much* to buy. The study of general business conditions and a thorough knowledge of the local industrial situation aid greatly in determining whether the volume of sales shown in the records is likely to increase, decrease, or remain stationary. The effect of such

factors as changes in style, increased sales-promotion activities, lower prices, and keener competition should not be overlooked.¹ The nature of the product and the character of the demand constitute basic controlling factors.

An analysis of properly designed sales records reveals the price lines, sizes, colors, styles, patterns, and types of merchandise that are in greatest demand in any given market. The alert management knows what the trend is and quickly detects any change in its direction for any given product or line of products. During the period 1923-1930 the sales of 5-cent cigars, for example, increased 40.4 per cent, while the sales of cigars retailing from 5 to 8 cents decreased 64.3 per cent. Out of every hundred cigars sold at the beginning of 1930, thirty-four sold for 10 cents, and fifty-five at 5 cents. According to a survey made by Marshall Field & Company, the "right" price for men's suits and overcoats was found to be \$35.00; shoes, \$6.50; pajamas, \$2.50; ties, \$1.00; and handkerchiefs, 25 cents. A drastic change in economic conditions or in the purchasing power of the dollar would likely make necessary a corresponding change in the "right" price.

The demand for candy, for example, is reported to be greatly affected by holidays; thus around St. Valentine's Day sales increase 9 per cent above the all-year normal; on Mother's Day the increase is 20 per cent; at Thanksgiving time it is 28 per cent above; at Easter, 42 per cent above; and during the Christmas season sales jump to 141 per cent above the normal.

Maximum and Minimum Stocks.—A number of successful firms prevent their stocks from growing too large or too small by establishing minimum and maximum limits. When the amount on hand decreases to a predetermined amount, orders are placed for new deliveries. The amount on hand at any time cannot be larger than the maximum. Definite stock-sales ratios based on past experience, extending over a considerable period of time, should be set up as a guide for each department. The stock-sales ratio for retail stores should indicate the volume of stocks necessary at the beginning of the month to accommodate the anticipated volume of sales during that month; due consideration must be given, however, to the seasonal character of demand and to the other factors and conditions that influence the volume of sales.

The determination of the amount of these two limits depends upon such factors as the seasonal and style elements of the demand, the perishability of the product, the normal rate of sale, and of turnover, the time necessary to secure delivery from date of ordering, volume of orders outstanding, and the probable volume of sales during the immedi-

¹ Want slips and shoppers' reports also furnish valuable information about what the consumer wants and what competitors are doing to meet consumers' needs.

ate future. The aim of the management should be to have adequate stocks to meet the anticipated demand, yet avoid an overstocked situation. A good system of stock control reveals what customers prefer, and indicates when stocks on hand become low or excessive.

These same fundamental principles can be utilized by the manufacturer as well as by the retailer and the wholesaler. The manufacturer should govern his production for stock by his knowledge of the character of the demand and the normal rate of flow from his warehouse into the hands of the ultimate user. Hand-to-mouth buying has always caused the producers, importers, and wholesalers considerable worry. During periods of falling prices and rapid changes in style this practice may assume for obvious reasons, great proportions. Thus the rapid decline in retail prices from 1929 to 1933 caused manufacturers and merchants to resort more and more to hand-to-mouth buying; the expectation of inflation in 1933 and 1934 led to a change in policy. The failure of inflation to arrive as expected, the doubt as to the constitutionality of the N.I.R.A. and the A.A.A., led to a change back to hand-to-mouth buying in 1935. The great improvements since 1920 in the facilities for rapid transportation of merchandise have greatly promoted hand-to-mouth buying. The costs of marketing for many producers might be considerably reduced if they were to make specific studies in their own industries as to the extent, causes, and effects of this practice; using the facts secured through such studies, more effective policies and methods could be established to meet the situation.

Returned Goods.—The costs of marketing are increased and the goodwill of the seller is frequently decreased by those conditions that cause purchasers to return merchandise. It is recognized that some purchasers do not buy in good faith; they do not intend to keep the merchandise when they buy it; or their judgment is so unstable that they may become dissatisfied before the goods are delivered. This group, however, is relatively unimportant. It has been said that women buy apparel for one of the following reasons in the order given: appearance, quality, and style. They are also interested in price. If, after making a purchase, they discover that the merchandise is not what they thought it was when they bought it, with reference to style, quality, fit, color, and general appearance, they will, in all probability, return the goods to the seller.

That the reasons for the return of merchandise arise largely as a result of faulty management is suggested by the following instances. One study reports, for example, that in some stores the returns were ten times greater than for the stores showing the smallest returns. The average amount of returns for a group of department stores amounted to 14.2 per cent. The returns are greater for some lines of merchandise

than for others; thus 21.3 per cent of sales of shoes were returned and 14.3 per cent of women's wear. Many of these returns were made, no doubt, because the salesperson had failed to satisfy the buyer with reference to size, last, fit, or quality.

Mark-downs.—Poor management in marketing is likely to show up prominently in the mark-down figures. While mark-downs are necessary in almost any store doing an active business, the amount of this repricing is greatly reduced through careful buying and intelligent sales-promotion activities. The purpose of a mark-down is to remove the merchandise so priced *promptly* and *permanently* from the store. A survey of a group of department stores revealed the fact that the mark-downs averaged more than three times the average net profits in those stores.¹ Some successful merchants believe that prompt and vigorous effort to dispose of unwanted merchandise helps to reduce mark-down losses.

The following figures illustrate the variation in mark-down figures, according to lines of merchandise. Mark-downs on women's dresses ranged from 18.1 to 11.0 per cent; women's suits and coats, from 15.5 to 8.9 per cent; blouses and skirts, from 11.3 to 5.5 per cent; women's shoes, from 10.0 to 7.3 per cent; men's clothing, from 8.2 to 6.1 per cent; drugs and toilet goods, from 4.5 to 3.2 per cent; silks and velvets, from 7.7 to 6.5 per cent; gloves, from 8.2 to 4.4 per cent; linens, from 5.1 to 4.2 per cent.²

The following list of causes for mark-downs indicates the relative importance of each.³

Causes	Per Cent of Total Mark-downs
Special sales.....	36.1
Broken assortments.....	35.0
No reason given.....	9.5
Wrong styles or patterns.....	8.0
Price adjustments.....	5.8
Wrong quantities.....	2.2
Wrong colors.....	2.1
Wrong fabrics or quality.....	1.4
Wrong sizes.....	0.6
Allowances to customers.....	0.5
Promotional remainders.....	0.4
Stock shortages.....	0.3
Policy allowances.....	0.1
Total.....	100.0

¹ CARTER, SIDNEY, *The Handbook of Modern Retailing*, p. 3.

² *Handbook for Merchants*, *op. cit.*

³ Bureau of Business Research, Ohio State University. The study covered the experiences of eleven Ohio department stores and represented \$1,780,208.90 taken in mark-downs during a six-months' period.

It will be noted that more than one-third of the total amount of mark-downs was due to special sales. The question naturally arises as to whether this was necessary. It might have been because of poor buying, a failure to understand the consumer market, or ill-advised pricing in the original mark-up. The special sales may have been a part of the firm's general sales-promotion activities. If this was the case, serious doubts arise as to the soundness of the sales and price policies. Would not a steady day-to-day sales-promotional plan have been more profitable in the end? The Department of Commerce found, in its study "Merchandising in Country Drug Stores," that special sales were due chiefly to the druggist's desire to advertise his store, to increase his sales volume, and to dispose of old stock. Such objectives may be commendable but a proper balance in the methods of attainment should be maintained.

Some Illustrations.—The following summary of generalizations drawn by Secrist and Folse¹ in their study of retail hardware stores for the three years, 1923, 1924, 1925, serves to illustrate the importance of standards for gross margins, total expenses, net sales, and net profits. It indicates also some of the factors that control the individual standard.

It is generally true, in the case of:

- I. Gross margins, that
 1. At a given time, margins in retail hardware stores are widely different.
 2. Margins increase with unit increase in expense up to an amount of approximately \$27.50 per \$100 of sales. Beyond this expense they tend to remain constant.
 3. Margins that are relatively low or high in a given year tend to increase or decrease, respectively, in the following year.
 4. Margins of stores in different volume groups tend to decrease as volumes increase, and to increase as cities increase in size.
- II. Total expense, that
 1. At a given time, the expenses of operating stores vary widely.
 2. Amounts of and changes in expense vary widely with those in margins.
 3. Expenses tend to decrease as the volume of sales increases.
 4. Expenses tend to increase as cities increase in size.
 5. Expenses that are relatively low one year tend to increase, and those that are relatively high tend to decrease.
- III. Net trading profit or loss, that
 1. Profit cannot normally be expected when sales are less than \$25,000 a year.
 2. With annual sales between \$25,000 and \$60,000 merchants may expect to do little more than break even.
 3. If annual sales are somewhat above \$60,000 a year, a profit, say, of 1 to 2 per cent on sales may in reason be expected.
 4. On the basis of sales usually secured by merchants in cities of less than 3,500 population, statistics will usually show losses or at best a profit of less than $\frac{1}{2}$ cent for each \$100 sales.
 5. Chance of securing profit increases with size of city. Not more than 1.5 per cent of sales can be expected in cities of more than 50,000.

¹ *Margins, Expenses, and Profits in Retail Hardware Stores.*

6. Losses tend to prevail when expenses are as much as $27\frac{1}{2}$ per cent of sales. When expenses are below this figure profits generally obtain.
7. Losses tend to prevail when margins are less than 25 per cent of sales, when they are $27\frac{1}{2}$ per cent or more profits are the rule. When they are between 25 and $27\frac{1}{2}$ per cent merchants may expect to do little more than break even.
8. It is more difficult to secure margins which will equal or exceed high expenses than it is for them to incur expenses which will be equal to or exceed high margins.
9. Conditions favorable to profits are low margins and low expenses, i.e., below the limit of $27\frac{1}{2}$ per cent of sales.

Unprofitable Accounts.—There exists among many manufacturers, wholesalers, and retailers a desire for large volume of sales. Many manufacturers and some wholesalers have exerted great effort to secure national and even international distribution. Large volume and wide distribution are worth-while achievements only when they are secured economically. Volume and distribution that are secured at excessive costs are objectionable not only from a social point of view but also from a business viewpoint.

The management of a firm should plan its sales records in such a manner that an accurate analysis can be made which will show the volume of sales, total expense, and net profit of each account. Those accounts that do not pay their way should, in many instances, be dropped. Some other firm may be able to handle them at a lower cost.¹

Inefficiency among Small Retailers.—There is an amazing number of small retailers throughout the country whose volume of sales is so small that they cannot hope to earn a living wage, much less show a profit on their investment. The Census of Distribution in Eleven Cities for 1926, made by the Department of Commerce, revealed glaring inefficiencies due to the attempt to operate retail stores on insufficient sales volume. Twenty-eight per cent of approximately 80,000 independent retailers had annual sales of less than \$5,000. The total sales of the 28 per cent accounted for only 1.68 per cent of the total volume of the 80,000 stores. The sales of 50 per cent amounted to only 4.5 per cent of the volume of the entire group. Eighty-eight per cent of the total group had

¹ The main specific reasons why country druggists buy from a given source of supply are, in the order of preference: service, price, and completeness and suitability of stock carried by the supplier. This class of retailer buys direct from the manufacturer when he can secure better discounts or prices, when he can secure merchandise not readily obtainable elsewhere, and when he can secure dealer helps or free advertising. The country druggist prefers, ordinarily, to buy from the wholesaler for the following reasons: better service, needs to carry less stock; he believes the wholesaler is essential to the success of the retailer, so he feels that he should support the wholesaler; and transportation costs are less when purchases are made from the wholesaler. "Merchandising in Country Drug Stores" *op. cit.*, Department of Commerce.

annual sales of less than \$50,000 each. Total sales of the 88 per cent were only 29.47 per cent of the total volume. A relatively small number, only 11.34 per cent, had annual sales of above \$50,000, yet this small number did 70.53 per cent of the total business. The Census of Distribution for 1929 and the Census of American Business for 1933 indicated that this situation is quite general throughout the country. The Census for 1933 reveals, for example, that 65.21 per cent of the total number of retail stores in Georgia had sales of less than \$10,000 annually; this group, however, accounted for slightly less than 16 per cent of the total volume of retail sales in the state. Forty-eight per cent of the total number of stores had sales of less than \$5,000; this group accounted for only 7 per cent of total sales. In the State of Oregon 63.9 per cent of the total number of stores secured sales of less than \$10,000. This group of stores accounted for only 14.6 per cent of the total retail volume of sales in the state. Each state shows a different relationship, but the general pattern remains very much the same for comparable situations.¹ The dominantly agricultural states tend to show a larger proportion of low-volume stores than the industrial and more densely populated states. In Oregon, for example, the average annual sales per rural store were only \$8,800 while stores located in urban places secured an annual average of \$16,300.²

Increasing Efficiency through Eliminating Unprofitable Accounts.—A wholesale hardware firm, after carefully studying its sales and sales territories with the idea of reducing its selling expense, came to the conclusion that any retailer whose annual purchases were less than \$600 was decidedly unprofitable. This firm's 1,432 retail accounts were tested against this volume standard. As a result, 700 retail accounts were dropped; this reduced the sales territory about 33 per cent. The firm had previously analyzed the stock of goods to determine profitable and unprofitable lines. This led to a 30 per cent decrease in stock. As a result of the reduction in accounts, territory, and stock, the volume of sales was reduced 33 per cent. After a three-year operating test it was found that the dollar volume of net profit had increased 35 per cent, while the relation of net profits to sales had increased 68 per cent. Operating costs were reduced by 4 per cent of gross sales below the average for similar firms in this particular field.³ The Coca-Cola Company found, upon analyzing the sales of its dealers, that 30 per cent of them

¹ W. H. Meserole of the Department of Commerce has analyzed the 1933 retail census figures in such a manner as to indicate the volumes of sales of small and large retail stores in rural and urban places.

² Meserole, W. H., *Domestic Commerce*, July 20, 1935.

³ "Analyzing Wholesale Distribution Costs," *Distribution Costs Studies*, 1, pp. 10 ff., Bureau of Foreign and Domestic Commerce, U. S. Department of Commerce.

did 60 per cent of the business, 35 per cent did 30 per cent, while the remaining 35 per cent of the dealers produced only 10 per cent of total sales.¹ A large manufacturer found, upon careful investigation, that 50 per cent of his accounts furnished only 6 per cent of the gross sales volume. No doubt a large proportion of the profit realized from the 50 per cent that provided the 94 per cent of sales was absorbed in selling to the large number of small customers. It seems to be quite common for manufacturers to secure as much as 80 per cent of their business from 20 per cent of their customers. A wholesale hardware dealer discovered that by cutting the number of his customers 56 per cent, his sales territories 28 per cent, the varieties carried by 31 per cent, and the number of manufacturers from whom he was buying 19 per cent, he was able to increase his annual net profit by 35 per cent.² Dr. Wittwer cites instances of a manufacturer who received only 4.5 per cent of his sales volume from 72 per cent of his customers, but this 4.5 per cent of sales required 25 per cent of the total marketing costs of the firm; another firm learned, upon analyzing its sales figures, that 85 per cent of the customers gave only 6.4 per cent of the total sales, but required 25.6 per cent of the total marketing expense.³ An interesting case was reported in *Sales Management*. A firm sold 800,000 cases a year at an average profit of 2½ cents a case. Analysis of customers and purchases disclosed that a profit of 20 cents a case was secured on 50 per cent of the gross volume of sales secured in the home territory while a loss of 15 cents a case was incurred on the 50 per cent sold nationally. The firm was getting less than 5 per cent of the potential business in the home territory. Methods were changed so that the firm secured a net profit of 11 cents on almost the same volume. Business in the home territory was increased almost 50 per cent to compensate for a loss of 66 per cent in the national business.⁴

Costs More to Sell to Retailers than to Wholesalers.—The combined selling and administrative costs of forty-three manufacturers selling exclusively or more than 90 per cent to wholesalers averaged 7.18 per cent of sales, while seventeen mills selling exclusively or more than 90 per cent to retailers showed average combined selling and administrative costs of 16.64 per cent of sales. The mills selling to wholesalers showed an average combined selling and administrative cost of 8.83 per cent lower than the mills selling to retailers.⁵

¹ Turner Jones, advertising manager, in a speech before the Milwaukee Advertising Club.

² WELD, L. D. H., "Lest We Forget," *Printers' Ink Weekly*, Nov. 10, 1932.

³ *Bull. of the Taylor Society*, Vol. XVIII, No. 3, pp. 53 ff., June, 1933.

⁴ October, 1935.

⁵ Report on the hosiery industry by the U.S. Department of Commerce, quoted by Eliat Garrison in a speech, "Distribution Through Wholesalers," Augusta, Ga., Apr. 26, 1935.

Securing Efficiency through Eliminating Unprofitable Orders.—Another practice, closely related to the one discussed above, that tends to increase unduly the costs of marketing, is selling in small orders. Competition among wholesalers and manufacturers for the business of retailers has encouraged purchasing in small lots. Hand-to-mouth buying; too frequent solicitation of dealers' business on the part of wholesalers' and manufacturers' salesmen; solicitation of the dealers' business by salesmen of too many wholesalers and manufacturers; and sales of broken-package quantities at standard-package prices tend to promote small-order buying on the part of the retailer.

The Department of Commerce found that the *average order given wholesalers* by country druggists was \$26.90;¹ the average number of items per order was 15.8; and the average value per item order was \$1.70. The country druggists ordered on the average 6.6 times a month. The druggists in the larger towns and with the larger sales volumes seem to order somewhat more frequently. The Wholesale Dry Goods Institute discovered that of a certain number of wholesalers surveyed every firm reported that 46 per cent or more of its orders were for \$25 or less; 36 per cent of the orders were for less than \$10; only 9 per cent of the orders were for \$100 or more. The \$10 and less orders provided only 6 per cent of the total volume of business, while the \$100 and more orders provided 37.6 per cent of the volume. It is a well-known fact that it costs more, relatively, to handle small orders than large ones.

A large manufacturer selling to electrical, automotive, hardware, and drug jobbers, found that 60 per cent of the orders provided only 8.7 per cent of the total gross sales. The same firm made a study of its jobbers' orders received from retailers and found that 50 per cent of the orders gave only 7 per cent of the jobbers' gross volume.

A Department of Commerce study indicated that 25 per cent of all customers' orders were for less than \$1 and provided only 5 per cent of total sales; 20 per cent of the orders were for \$4 and above, but accounted for 50 per cent of the total business.²

An analysis of the cost of handling individual orders in the office, made by the Western Electric Company, indicated that the expense on small orders—those with a value less than \$25—varied from \$3.25 to \$5.00, while the average gross profit averaged from \$0.71 to \$4.48. The average amount of loss on these orders was about \$1.63, and as such orders represented about 60 per cent of all orders, the aggregate annual loss amounted to more than \$750,000. Table 90 shows in some detail the effect of the size of the order upon expenses and profit in this firm.

¹ "Merchandising in Country Drug Stores," U.S. Department of Commerce.

² "Practical Aids to the Independent Merchant," pp. 4 ff., Bureau of Foreign and Domestic Commerce.

Dr. Lyon found, for example, that the costs for handling lots of 25 cases was 28 per cent greater per unit than for lots of 100 cases; and that orders of 100 cases cost 6 per cent more per unit than carload orders.¹ The cost per unit for maintaining records was found to be $11\frac{1}{2}$ times as great for the orders of 25 cases as for the orders in car lots. The increased costs of packing in 25-case lots is approximately 56 per cent more than for 100-case orders. The costs of billing are about the same, irrespective of the size of the order. The cost of loading, however, is about 2.4 times as great per unit for 100-case lots as for car lots. Freight costs appear to increase about 62 per cent when shipments are reduced from car lots to 100-case lots. No appreciable increase in costs per unit appear when orders are reduced still further.

TABLE 90.—RELATIVE PROFITABLENESS OF ORDERS¹

Classification of items	Total	Over \$25	Under \$25	\$10-\$25	\$5-\$10	Under \$5
Number of orders.....	772,000	309,000	462,000	162,000	108,000	193,000
Percentage of total.....	100	40	60	21	14	25
Value of orders.....	\$46,607,160	\$42,577,800	\$4,029,360	\$2,783,160	\$783,000	\$463,200
Percentage of total.....	100	91.3	8.7	6	1.7	1
Average value per order..	\$60.37	\$137.80	\$8.70	\$17.18	\$7.25	\$2.40
Gross profit, total.....	\$8,716,550	\$7,630,200	\$1,086,350	\$725,760	\$223,560	\$137,030
Average per order.....	\$11.29	\$24.70	\$2.35	\$4.48	\$2.07	\$0.71
Expense:						
Average per order.....		\$14.58	\$3.98	\$5.00	\$3.74	\$3.25
Net profit:						
Total.....	\$2,369,680	\$3,124,500	-\$754,820	-\$84,240	-\$180,360	-\$490,220
Average per order.....		\$10.12	-\$1.63	-\$0.52	-\$1.67	-\$2.54

¹ *Distribution Costs Studies*, 1, p. 11, U.S. Department of Commerce.

Selective Selling.—Dr. Wittwer suggests the following steps in developing a plan for selective marketing.² The statement also summarizes the ideas presented in our preceding discussion.

1. Analyze sales and selling costs by commodities, items, orders, customers and territories. Determine the minimum size of order that can be filled at a profit and the smallest account which can be profitably carried.

2. Prepare a list of customers representing the maximum volume of business and the minimum number of accounts. Include in this list all potentially large customers not being sold at the present time.

3. Prepare a second list including all customers found to be worth soliciting but not appearing on list one.

4. Make contracts or other special arrangements such as discounts, commissions, terms, exclusive territories, agency franchise, etc., which will result in mutual benefits and insure goodwill and special attention to the particular products in question.

¹ *Some Trends in the Marketing of Canned Foods*, pp. 41 ff.

² *Bull. of Taylor Society*, op. cit.

5. Develop a staff of salesmen specially trained and prepared to deal with the star customers.

6. Stop soliciting accounts which are not potentially profitable and avoid making too frequent calls on customers in the second list mentioned above.

7. Except in the case of sample orders, refuse to accept orders which call for items or units in less than standard package lots.

8. Make arrangements to take care of incidental business which comes in unsolicited from small customers, so as not to give offense or create a spirit of hostility, but aim to reduce such business to a minimum.

In any plan of selective selling, due consideration must of course be given to decent business ethics and restrictions imposed by law.

The Effect of the Size of the Retail Sales Unit.—The Louisville Food Distribution Survey presents some interesting information concerning the relative profitableness of sales units of different sizes. One brand of butter, for example, was sold in quantities of one pound, one-half pound, and one-quarter pound. By using the system of costing devised for the survey, it appears that there was a net profit of 4 cents on each sales unit when sold in one-pound lots, while there was but 1 cent profit on each half pound, and a net loss of 0.6 cent on each quarter pound sold.

The Importance of Effective Inventory Control.—The Department of Commerce, in its attempt to aid in the reduction of inefficiency in marketing, has brought to light a number of specific examples of merchandising practices responsible for excessive costs. Some of these are cited as illustrations of poor management for which adequate standards should be developed. It was found that a certain wholesale grocer carried 2,100 items in his inventory while representative grocery chain-store warehouses handling an even larger volume of business carried as few as 700 items. The latter secured stock turns of twenty times annually, while the former secured a stock turn of only seven times. For the wholesale grocer, four items—tobacco, sugar, provisions, and flour—supplied 49 per cent of total sales but required only 17 per cent of the inventory investment and 15 per cent of the total warehouse space. Four additional groups—canned vegetables, canned fruits, condiments and spices, and canned meats—added only 14 per cent to total sales, but required 49 per cent of the inventory investment and more than 50 per cent of the warehouse space.

An Illustration from the Retail Field.—An analysis of the stock carried in retail grocery stores, made by the Department of Commerce, indicates no better condition among the independent retailers. What is believed to be a typical case showed that five classes of merchandise which required just 10 per cent of the inventory provided 50 per cent of the sales. Nine other classes of merchandise required nearly 50 per cent of the inventory but brought in only 14 per cent of the sales. This same grocer had on his shelves forty-two items of tea. Six of these

forty-two items provided almost 50 per cent of the total tea sales, leaving the thirty-six other items to compete for the other half of the tea sales.

Simplification.—The elimination of unnecessary variety of products, sizes, dimensions, types, models, patterns, colors, and other physical qualities, and the concentration of effort on a relatively small number of standard products, offer opportunities for economies in manufacturing and marketing. Simplification in practice is merely the concentration of effort on varieties in common demand. Careful surveys of the sales of a number of industries and of individual firms show, as was stated previously, that as much as 80 per cent of the business often comes from 20 per cent of the varieties in which the product is offered to the trade. The 80 per cent of the varieties producing but 20 per cent of the year's business is subject to elimination on the basis that it does not pay its way.

The arguments for simplification are well stated in the following quotation.¹

On the side of the manufacturer is the natural desire to have something different from his competitors in order to put forward a real or imaginary superiority in his product. There is, therefore, a natural tendency to bring out new and "improved" models, while possibly continuing to manufacture the old lines. There is also the desire and need to produce a line of goods to satisfy varying purchasing power of customers. Thus phonographs and automobiles are produced in a wide range of qualities and prices. This tendency upon the part of the manufacturer has been greatly increased by the attitude of the modern aggressive salesman who, in order to combat the resistance of a purchasers' market, demands new and more attractive designs.

On the part of the purchasing public there tends to be a demand for products having individuality. Many people wish to have writing paper, pocketknives, or automobiles unlike their neighbors'. In wearing apparel and other personal accessories, the demand for changes in fashion is pressed both by the purchaser and the manufacturer. As an extreme illustration of this tendency, colored bed linen has lately been put upon the market. These desires upon the part of both producer and consumer have brought about such a complexity as to give rise to a well-defined movement not only to check this tendency where possible, but also to eliminate some of the existing wastes due to it.

The specific application of simplification to marketing and the character of the possible savings therefrom, according to Mr. Hudson,² are indicated in the following outline.

ADVANTAGES OF SIMPLIFICATION

I. To the distributor:

A. Increased turnover due to:

1. Concentration of stock.
2. Staple lines, easy to buy, quick to sell.

¹ *Recent Economic Changes in the United States*, Vol. I, pp. 68 f.

² HUDSON, R. M., formerly assistant director, National Bureau of Standards, in an address given before the Milwaukee Association of Purchasing Agents.

3. No slow-moving numbers.
4. More effective sales force.
5. More concentrated sales effort.
- B. Less overhead and better service:
 1. Through lower handling charges.
 2. Less stock depreciation.
 3. Smaller clerical forces.
 4. Less obsolescence.
 5. Quick and reliable delivery.
 6. Fewer misunderstandings and errors.
- C. Decreased capital requirements:
 1. Fewer complete lines to carry.
 2. For maintenance stocks.
 3. For packing materials.
 4. For storage space.
 5. For interest and other charges.
 6. Less operating margin required.
- II. To the consumer:
 1. Better value for money.
 2. Better quality.
 3. Prompt deliveries.
 4. Quick replacement service.
 5. Lower maintenance costs.
 6. Simplified specifications.
 7. Protection against unscrupulous traders.

The National Bureau of Standards of the U.S. Department of Commerce has been active in promoting simplification in marketing as well as in production. Among many of the instances of simplification of lines of merchandise cited are: A well-known eastern wholesaler of hardware who reduced his stocks from more than 10,000 items to 7,000, eliminated 28 per cent of his territory and dropped 56 per cent of his customers. The result was that his percentage of "net" to "sales" increased 68 per cent. A chain of drugstores reduced its average store stock from 22,000 to 10,000 items. The result was an increase of 70 per cent in turnover, 43 per cent in the volume of business, and 100 per cent in its wage rates with a decrease of 14 per cent in average store investment, 67 per cent in inventory time, 56 per cent in the cost of taking inventory, and 58 per cent in store personnel. Payroll cost dropped from 20 to 11 per cent of sales, and rent from 14 to 7 per cent of sales. A large railroad cut its store stock from 52,000 to 32,000 items and its inventory from \$3,320,000 to \$805,000. Another railroad reduced its store stock 44 per cent and by so doing released nearly \$40,000,000 of idle capital.¹

Another illustration of the need for simplification is found in the case of the canning industry. The tomato pack of 1928 included cans of the following sizes: 5 oz., 6 oz., 6½ oz., 8 oz., 10 oz., 11 oz., 12 oz.,

¹ *Commercial Standards Monthly*, Vol. 6, No. 5, pp. 114 ff.

15 oz., 16 oz., No. 1, No. 1 Tall, No. 1½, No. 2 Squat, No. 2, No. 2½, No. 3, No. 5, No. 9, No. 10, No. 93, No. 95, and No. 303. In addition to these twenty-two sizes of cans, tomatoes were packed in glass jars of an endless variety of sizes and shapes. This condition has not materially improved since these facts were first published. It is believed that the requirements of the trade would be met satisfactorily and at a considerable reduction in cost if five can sizes, six at the most, and three sizes of glass jars were substituted for this unstandardized array.

There are definite limits to the practice of simplification and standardization. Many shopping and specialty lines of merchandise which the consumer purchases for display purposes cannot be simplified to such an extent that people cannot satisfy this desire. People are not ready for uniforms; they want to express their individuality through the ownership and possession of certain articles of dress, automobiles, furniture, and household equipment. The variety of paving bricks and milk-bottle caps can be more radically reduced than women's hats and men's ties. Competitive selling has a tendency to multiply variety. The economic benefits of simplification will no doubt greatly extend its use in all lines of merchandise with the exception of those endowed with a high degree of fad and fashion characteristics.

Costs and Profits.—Men enter business primarily for the profit they hope to secure in return for the risks they assume. Profit constitutes, according to Knoeppel, "reward for skill, ability, experience and knowledge; incentive for effort and endeavor; protection against chances which must be taken; justification for research and experimentation; insurance against losses which are entirely unforeseen; assurance of business success and perpetuation."¹ This attempt to justify profits does not condone profiteering against the consumer and exploitation of labor. A reasonable monetary return for the assumption of the responsibilities listed above is all that is economically sound and socially justifiable. To take more may be regarded as shortsighted and antisocial, and to take less will probably lead to economic suicide.²

¹ KNOEPPEL, C. E., *Profit Control—How to Insure Steady Profits through Predetermined Costs*, p. 211.

² Normally, it is said, 40 per cent of all business firms enjoy no profits; 40 per cent secure small profits; and 20 per cent enjoy large profits. In 1928 approximately 54.2 per cent of all corporations enjoyed some net income, 35.3 per cent secured no income, and 10.5 per cent were inactive. In 1932 only 16.3 per cent had net incomes, 72.6 per cent had no net income, and 11.1 per cent were inactive. There were 508,636 corporations in 1932. In 1931, 37.6 per cent of the corporations secured net returns; this group did 48.6 per cent of the business; 62.4 per cent secured no net income, but accounted for 51.4 per cent of the business for the year. *Business Week*, July 6, 1935.

According to a study by Dun & Bradstreet only two lines of business activity disclosed profits for each year during the period 1931, 1932, and 1933. These fortunate lines were wholesalers of butter, eggs, and cheese, and wholesale grocers. The

The profit from the marketing activities of a firm depends upon the differences between the selling price and the expenditures involved in consummating the sale. Since the price that can be charged depends so much upon competition, purchasing power of the customer, and the relation of supply to demand, sellers are giving a great amount of attention to ways and means of determining the amount and nature of the costs of marketing. If these expenditures can be lessened more than prices are reduced, the net profit will tend to go up. The hope of the efficient marketer is to reduce costs. There is little hope for the ones who cannot effectively control their costs of operation.

The development and the operation of a system of cost accounting for marketing are more difficult than for production. Selling costs are a deduction from income; they add nothing to inventory. These costs comprise direct, indirect, and joint charges. The distribution of the indirect and joint charges presents difficult problems in apportionment. The science of cost accounting for marketing is still in its infancy.

The major guiding purpose back of a system of cost accounting for marketing is to secure effective executive control over expenditures and thereby favorably influence costs and profits. The system of control must recognize the principle of delegation of authority and the assumption of responsibility for performance. The marketing functions must be performed by some individual or a group of individuals. The individual should be held responsible for the costs of performing his set of services. The management should know, for instance, the relative costs of selling a certain product through chain stores, branch houses, or by the wholesaler-retailer method. It should be able to answer such questions as: How do the size of order, density of outlets, and frequency of purchase affect the cost of selling? How does the cost of selling by mail compare with the costs of personal salesmanship? What are the advantages and disadvantages of selling through owned retail stores, independent, or chain retailers? The management, then, is interested in a record and report system that will give it comparative figures on the cost of selling (1) to different kinds and classes of buyers; (2) by different methods; (3) by various terms of sale; (4) in different territories; and (5) by classes of products. The determination of the cost unit is largely dependent on the policies of the firm, type of organization employed, variety and character of the products sold, methods of sales-promotion used, and the nature of the market cultivated.

Some firms have found it advisable to break down their selling cost figures into a number of pertinent subdivisions; for example, expenses

reason for the profits were rapid turnover of inventory and working capital, and the earning of a nominal profit on sales. The wholesalers of butter, eggs, and cheese enjoyed an increased percentage of profit each year.

connected with demonstrations, window displays, shipping, sampling, free goods, returned goods, warehousing, delivery, spoiled goods, conventions and contests, trade and cash discounts, general office expenses, and advertising allowances.

Marketing Costs of Merchants.—The expenditures of retail stores are classified by the Harvard Bureau of Business Research on two bases, viz., (1) *Natural Divisions*, and (2) *Functions*. The major items of expense, classified on the basis of natural divisions, are indicated below.¹

Total expenses:

- Total payroll.
- Real estate costs.
- Newspaper advertising.
- Direct advertising.
- Other advertising.
- Taxes.
- Interest (except on real estate).
- Supplies.
- Service purchased.
- Unclassified: Losses from bad debts,² others.
- Traveling.
- Communication.
- Repairs.
- Insurance.
- Depreciation (except on real estate).
- Professional services.

The major items under the functional classification are:

- Administrative and general.
- Occupancy.
- Publicity.
- Buying and merchandising.
- Direct and general selling.
- Delivery.

The two methods are combined in the analysis of *total expenses* and of *total payroll*. Thus the subheadings under the functional headings are based on the natural divisions.²

When sales are classified by outlet, salesmen, territory, classes of product, and by terms of sale, and when expenditures are revealed by an analytical system of cost accounting, profits and losses can be definitely determined and their causes recognized. A system of cost accounting for marketing will not in itself reduce wastes and generate profits. The statistical data presented by marketing costing are a means to an end; they furnish a basis for sound judgment and intelligent action. "Figures

¹ Bureau of Business Research, *Bull.*, No. 96, June, 1935.

² *Ibid.*

tell an interesting story and enable the seller to keep his finger on the pulse of his business."

The following table indicates the close relationship between profit, expenses, and gross margin for the kinds of businesses indicated.

TABLE 91.—SOME OPERATING FIGURES¹

Kind of business	Gross margin, per cent	Total expense, per cent	Net profit, per cent	No. stock turns	Average sales per employee, dollars
Wholesalers					
Automotive jobbers (sales above \$450,000)	28.96	25.36	3.60		
Wholesale druggists (one firm with sales above \$2,000,000).....		16.237		5.72	
Wholesale grocers ²	11.58	11.38	0.20	5.27	
Retail merchants					
Automobile tires and accessories.....	28.8	26.8	2.0	5.7	
Builders' supplies.....		34.58			
Drugstores ³	31.8-36.0	25.5-35.1	Loss 3.3 to a profit of 8.2	2.2 to 3.6	
Electrical stores.....	31.1	27.0	4.1	4.47	
Florists.....	45.6	38.0	7.6		
Twenty-three selected cash combination stores, 1934 ⁴	17.6	14.4	3.2		
Grocery stores					
Independent service.....	18.3	17.6	0.7	9.0	
Chains, including warehousing, transportation costs, and interest (with sales of \$50,000 to \$100,000).....	18.3	16.7	1.6	9.9	
Hardware stores (with sales of \$100,000 and above, in cities over 50,000 population)...	30.37	30.74	Loss 0.37	1.94	952
Jewelry stores.....	43.2	45.0	Loss 1.8	0.9	
Meat markets.....	29.1	26.5	2.6	57.4	12,521
Shoe stores (\$30,000 to \$75,000 sales).....	28.9	34.6	Loss 5.7	1.9	9,120
Specialty stores (sales \$500,000 to \$2,000,000)	37.0	38.5	Loss 1.5	5.2	5,700
Stationery stores.....	35.51	41.63	Loss 6.12		
Super-service stations.....	29.99	28.23	1.76		
Variety chains (sales of \$125,000 and above)	33.44	29.59	3.85	5.03	
Service Marketers					
Beauty shops.....		88.0	12.0		
Dyers and cleaners (national average).....		102.83	Loss 2.83		
Laundries (with weekly sales of \$5,000 to \$8,000).....		99.29	0.71		

¹ Table arranged from data published in *Better Retailing*, The National Cash Register Company.

² The average operating expenses of twenty-two Indiana wholesale grocers for 1927 was 10.26 per cent, with a net profit of only $\frac{1}{2}$ of 1 per cent. Eleven showed a profit while the others suffered losses.

³ Total expense—Eastern section—27.8 per cent; Central—27.1 per cent; North Central—25.5 per cent; Western—29.1 per cent; Southern—28.2 per cent; Middlewestern—35.1 per cent.

Margin—Eastern section—36 per cent; Central—32.0 per cent; North Central—32.9 per cent; Western—35.2 per cent; Southern—35.1 per cent; Middlewestern—31.8 per cent.

⁴ *Progressive Grocer* figures, published in *Domestic Commerce*, July 20, 1935.

A retail store may be thought of as an aggregation of stores. Each department has a different cost of operation; the figures usually given are averages of the costs of the various departments or "stores." In

its drugstore survey in St. Louis, the Department of Commerce found that the average selling expense for retail drug stores was 34 per cent of net sales. The selling expense figures for each of the nine major departments follow: sundries department, 52 per cent; prescription department, 49.3 per cent; toiletries department, 40.5 per cent; soda fountain, 37.9 per cent; confectionery department, 36 per cent; packaged medicines department, 27.1 per cent; hospital supplies department, 26.3 per cent; newspapers-magazines department, 21.5 per cent; and tobacco department, 14.2 per cent. The fountain department, for example, supplied 26.1 per cent of total store sales, enjoyed a gross margin of 46.1 per cent, and supplied a net profit of 8.2 per cent of sales, which was equivalent to 31.8 per cent of the total store net profit. The general idea applied to a specific instance is illustrated in the following quotation from the report.

In the development of the operating success of a [drug] store, each department should be developed as a separate and going establishment. Those departments showing losses in this case are the ones which, if looked at separately, would disclose faulty management as far as they, as departments, are concerned. . . . The [departmental] profit showings are revealed as the direct result of a favorable combination of gross margin, volume of sales, rate of turnover, average size of sale, and average selling time. The study disclosed, for example, that the fountain, with these factors generally favorable . . . produced the greatest dollar profit (volume) in the store. . . .

The following table gives the average ratios of 2,687 grocery wholesalers based on their operating figures for 1932. This table is interesting and valuable in that it indicates the variation that exists among whole-

TABLE 92.—AVERAGE RATIOS OF 2,687 CONCERNS BASED UPON 1932 OPERATIONS IN EIGHT IMPORTANT DIVISIONS OF THE WHOLESALE GROCERY TRADE¹

Group	Number of concerns	Current assets to current debts (ratio)	Net profits on net sales (per cent)	Net profits on tangible net worth (per cent)	Turnover of working capital (times)	Coffeetion period (days)	* Net sales to inventory (times)
Service wholesalers.....	1921	5.04	0.30	1.47	7.34	42	9.25
Cash-and-carry wholesalers..	117	4.06	0.73	4.51	8.69	21	6.20
Chain stores.....	127	4.55	0.58	3.47	13.28	..	13.23
Imported goods wholesalers..	92	5.25	0.04 (loss)	0.16 (loss)	4.73	60	8.39
Institutional wholesalers....	93	5.02	0.51	2.53	7.14	52	7.89
Retail owned wholesalers....	74	3.07	0.40	4.01	11.09	26	10.26
Voluntary group wholesalers	52	4.41	0.71	5.06	8.95	34	9.16
Miscellaneous specialty wholesalers.....	211	4.73	0.52 (loss)	2.25 (loss)	7.24	45	9.22

¹ Foulke, Roy A., "Important Financial Ratios of the Wholesale Grocery Trade," reprinted from the July, 1934, issue of *Dun and Bradstreet Monthly Review*—p. 5 of the reprint.

salers operating in the same general field, i.e., grocery. The net profits on tangible net worth of the voluntary group of wholesalers, for example, are outstanding, while the rate of turnover of working capital and the net sales to inventory for chain stores indicate a worth-while achievement. The collection period for the imported goods wholesalers is 60 days; for cash-and-carry wholesalers, 21 days; for the chains, none.

*Manufacturers' Marketing Costs.*¹—The Association of National Advertisers, Inc., published, in 1933, *An Analysis of Distribution Costs of 312 Manufacturers for 1931*. The manufacturers were classified into two major groups—those producing industrial goods, and those producing consumer goods. The following classification of costs was used in this study.

DISTRIBUTION COSTS OF MANUFACTURERS²

1. Direct selling costs.
 - a. Salaries.
 - b. Traveling.
 - c. Office.
 - d. Other.
 - e. Total direct selling costs.
2. Advertising and sales costs.
 - a. Advertising.
 - b. Administrative.
 - c. Samples.
 - d. Total advertising and sales costs.
3. Transportation costs.
4. Warehousing costs.
5. Credit costs.
 - a. Collecting.
 - b. Bad debts.
 - c. Total credit costs.
6. Financial costs.
7. General administrative costs.
8. All other costs.
9. Total distribution costs.

Table 93 serves to illustrate the wide variation in marketing costs in the grocery manufacturing field.³ The costs vary from 5.5 per cent of net sales for manufacturers of flour to 37.2 per cent of net sales for manufacturers of soaps, cleansers, and polishes. The nature of the product, the buying behavior of the consumer, and the relative competitive conditions under which each is sold account chiefly for the great variation in costs. The report which was made by the Bureau of Business

¹ For an interesting general discussion of marketing costs, consult W. B. Castenholz, *The Control of Distribution Costs and Sales*.

² For the figures on costs and an interpretation of the variation in the costs refer to pp. 442 and 443 of this text.

Research, Harvard University, covered the marketing activities of seventy-two concerns with aggregate annual sales of almost \$700,000,000; thirteen of the firms had sales of \$10,000,000 and over; twenty-six had sales of from \$1,000,000 to \$10,000,000; the remaining firms had sales of less than \$1,000,000. The items included under marketing costs were sales force and brokerage; sales promotion and advertising; shipping, transportation, warehousing, and delivery; credit and collections; and marketing administration.

TABLE 93.—MANUFACTURERS' MARKETING COSTS IN VARIOUS GROCERY LINES¹

Product	Total Marketing Expense, Per Cent of Sales Price
Flour.....	5.5
Meat packers.....	7.0
Canned and bottled foods.....	17.0
Coffee, tea, chocolate, spices and extracts.....	17.5
Cereals, crackers, macaroni, salt and preserves.....	26.9
Soaps, cleansers, polishes.....	37.2

Advertising and Selling, pp. 22 ff., Dec. 12, 1928.

The Department of Commerce found in its Louisville survey that retailers secured the indicated gross margins for the designated products: flour, 17 per cent; fresh meats, 29.7 per cent; smoked meats, 20.8 per cent; fish and poultry, 23.7 per cent; canned goods, 26.9 per cent; coffee, 19.4 per cent; cereals, 24.5 per cent; sugar, 22.4 per cent; tobacco, 23.7 per cent; and dairy products, 18.2 per cent. The last group had a turnover rate of 114. Fresh meats, smoked meats, coffee, sugar, and flour produced, in the order listed, the greatest net profits. Published in *Business Week*, Oct. 5, 1932.

The wide differences in the marketing costs of these manufacturers of grocery and meat products emphasize the importance of establishing standards of operation carefully and judiciously. A knowledge of the costs of marketing flour and meat products, for instance, is of little help in setting a standard of marketing costs for soaps, cereals, or coffee. It is clearly evident that all factors must be comparable if operating statistics, based on average performance, are to be of service in judging managerial competency.

Costs of Marketing Agricultural Products.—It is estimated that in the marketing of agricultural products the average spread between the amounts the consumer pays and the farmer receives is equal to 55 to 60 per cent for milk, cream, and butter fat; 55 per cent for poultry; 30 per cent for eggs; 45 per cent for live stock; 30 per cent for grains; 50 per cent for potatoes; 70 per cent for vegetables and fruits. These amounts comprise all the costs and profits involved in transferring the products from the producer to the ultimate user. The retailer secures on an average 47 per cent of this amount. These margins tend to change as retail prices change. Thus the margins tend to widen when prices are low and to decrease when prices are high or when they are increasing.

An interesting account of a survey by Mr. Rice to determine the cost of marketing potatoes¹ was published in *Nation's Business*.¹ He traced the costs and the services involved from the grower to the home.

The farmer received 60 cents per 100 pounds from the local shipper, who received 70 cents per 100 pounds from the wholesaler in the central markets. The potatoes cost the wholesaler a total of \$1.36 per 100 pounds f.o.b. freight yards his own city when freight costs of 60 cents and heating costs of 6 cents were added. The wholesaler sold in average lots of 200 pounds to retailers for \$1.55 per 100 pounds. He thus made 180 deliveries for each carload of potatoes. His delivery costs alone amounted to 15½ cents per 100 pounds. The retailer sold his 200-pound order to consumers in average lots of 9 pounds after grading the potatoes and throwing away those not suited to his trade. He received \$2.11 per 100 pounds. He had a gross margin of 56 cents. The selling costs of the retailer under consideration were 7 per cent, and the delivery cost was 5.7 per cent of sales; after deducting other costs the retailer received a net profit of 16.74 per cent on net sales. This was equal to 14.22 cents per 100 pounds, which is less than one-seventh of a cent a pound. The writer of the article contends that this does not indicate

TABLE 94.—SPREAD BETWEEN THE FARM PRICES AND THE RETAIL PRICES FOR FOURTEEN FOOD PRODUCTS, 1924-1934*

Year	Retail value	Value at farm	Margin between values at farm and at retail	Farmer's share, per cent
1924	\$24.04	\$10.81	\$13.23	45.0
1925	26.24	12.54	13.70	47.8
1926	26.97	13.04	13.93	48.4
1927	26.16	12.19	13.96	46.6
1928	25.97	12.44	13.73	47.1
1929	26.11	12.40	13.71	47.4
1930	24.20	10.82	13.46	44.4
1931	19.89	7.55	12.35	37.9
1932	16.78	5.54	11.24	33.0
1933	6.44	5.81	10.63†	35.3‡
1934	18.39	6.90	11.49†	37.5‡

* From "Agricultural Adjustment in 1934," U.S. Department of Agriculture, Published in *Domestic Commerce*, July 20, 1935.

† Including processing taxes.

‡ Excluding benefit payments.

¹ Rice, M. M., "Hawshaw Shadows the Potato," *Nation's Business*, August, 1935, pp. 19 ff.

A friend had made the statement to the author of this article that there was too wide a spread between the price received by the farmer and that paid by the consumer, and that the middlemen were profiteering.

profiteering. A comparison of the 60 cents received by the farmer with the \$2.11 paid by the consumer without considering the services and costs involved leads to an unsound conclusion. The figures in this particular instance clear the middlemen concerned of any charges of profiteering. Some of the costs may be too high, but that is not a profiteering problem.

Table 94 shows what the typical family had to pay the retailer for a month's supply of fourteen foods during the period 1924-1934 inclusive. The amount received by the farmer, and the spread between what the consumer paid and what the farmer received, are also indicated; and, finally, the percentage of the retail price received by the farmer is given.

The student will recognize, of course, that these figures can be only rough approximations. Retail prices and farm prices vary widely from place to place and from time to time; the quality of the products, the nearness to market, the amount and quality of services rendered—all influence the costs. The retail figures in this example cover not only the strictly marketing costs, but also the processing and transportation costs.

The following table indicates the retail portion of the marketing costs for a list of fruits and vegetables.¹

TABLE 95.—RETAIL MARGINS FOR FRUITS AND VEGETABLES

	Per Cent
Leaf lettuce.....	55.2
Tomatoes.....	54.2
Rhubarb.....	53.5
Wax beans.....	51.0
Radishes.....	50.0
Celery.....	47.4
Spinach.....	43.7
Carrots.....	42.2
Beets.....	40.0
Green squash.....	39.6
Table onions.....	39.0
Cauliflower.....	37.3
Peas.....	33.9
Corn.....	32.5
Cabbage.....	28.2
Asparagus.....	26.0
Raspberries.....	24.2
Strawberries.....	19.7

Do these figures indicate that there is inefficiency in the marketing of agricultural products in general and that the retailer, in particular, gets too much of the gross? Not necessarily; the fact is, we do not know what the cost should be. We do not have, at present, adequate stand-

¹ Minnesota Agricultural Experiment Station, Bull. No. 236.

ards by which the performance can be judged. D. C. Roper, Secretary of Commerce, stated in 1935: .

It is astonishing that such a paucity of authenticated information exists. No analysis and measurement of costs of distribution has been made on a sufficiently comprehensive scale to provide conclusive evidence of what is wrong and what should be done. We do not know at what point or points in the movement of goods from their primary sources of supply or production to the final consumer the heavy burden of distribution costs arises.¹

Testing the Results of Marketing Performance.—The discussion so far has pointed out the need for certain standards and has cited a few illustrations exemplifying the value of sales analysis and the use of standards. A very practical question arises: Suppose dependable standards of operation have been established, how may we determine whether a given firm, department, or whatever factor is under consideration, meets these standards? This can be done only if the firm keeps an adequate set of records and prepares dependable reports so that the financial and marketing operations of the business can be accurately analyzed.

The management of a marketing organization or the marketing department of a manufacturing firm has two elements with which to accomplish results, *viz.*, (1) capital in the form of (a) merchandise, (b) equipment, fixtures, building, (c) location, (d) cash or its equivalent in credit; and (2) personnel—administrative, selling, and nonselling groups. The test of efficiency is how skillfully the elements are coordinated and used. The determination as to whether the particular management under discussion *has met and is meeting* the standards of operation being met by the managements of similar firms may be accomplished through a comparison of certain significant ratios.

Some Significant Ratios.—The information necessary to construct these ratios is secured from three sources—the sales records, the balance sheet, and the profit and loss statement. The ratios, when determined, may be used to compare the operating efficiency of the business with any standards that may be available or with the results secured by other comparable businesses. The ratios serve also as a basis for comparing the results attained from year to year in the same firm.

Comparing the Results of Sales Efforts.—The ratio of *cost of goods sold to net sales*, or, as it is commonly designated, the “operating ratio,” indicates the buying ability of the management, the competitive position of the firm, and the trend of the cost of the merchandise bought by the firm. If, for example, net sales amount to \$1,000, and the merchandise costs \$750, the ratio of the cost of goods to net sales is 75. This may be stated by saying that the merchandise costs 75 per cent of the net sales.

¹ *Domestic Commerce*, Mar. 20, 1935.

The ratio of *gross margin to net sales* is important because it is out of the amount represented by gross margin that expenses must be paid before any profit can be realized. The trend of this ratio indicates the future probable degree of success of the management. The public is interested in the size of the ratio, as a high figure may denote profiteering. A low figure, if accompanied with a large volume of sales and rapid turnover of stock, may prove more profitable to the firm than a higher figure with a lower volume of sales and rate of stock turn.

The ratios of *total selling expense to net sales* and *to total expenses* immediately center attention upon the operating efficiency of the management. It is usually desirable to go further and break down the selling expense figure into its component parts so as to show just what factors are responsible for any unduly high costs. Thus the following auxiliary ratios may very profitably be determined.

Ratio of:

Salaries of salespeople to net sales and to total selling expense.

Advertising costs to net sales and to total selling expense.

Occupancy costs to net sales and to total selling expense.

Delivery costs to net sales and to total selling expense.

Any other expense items that may be significant in the particular business to net sales and total selling expense.

In addition to the ratios mentioned, the *net sales*, *net profit*, and *selling expense* per salesman, store, sales territory, customer, order, and product, or major line of products, should be determined.

Another group of ratios indicated below, may be used to determine the efficiency with which certain marketing and related activities of a firm are administered.¹ Thus

The Ratio of:

1. *Net sales* to total capital used in the business; to total fixed capital used in the business; to average capital invested in merchandise; to current assets; and to current liabilities. These ratios indicate the degree of efficiency with which the capital is employed.

2. *Current assets* to current liabilities, to indicate the degree of liquidity existing. An analysis of the nature of these assets and liabilities is necessary for adequate control of credit sales.

3. *Net profit* to net sales; to gross margin; to net worth; and to total capital used in the business; to average inventory; to fixed capital; and to total selling costs. These ratios indicate whether adequate remuneration for the risks assumed is being received by the firm.

4. *Accounts and of notes receivable* to net sales and to inventory, to indicate credit, collection, and sales practices.

5. *Sales discounts* taken by customers to net sales. These two ratios (4 and 5) indicate the efficiency of the credit department.

¹ For a short and enlightening discussion on the analysis and interpretation of the items commonly found in the balance sheet and the profit and loss statement, consult Stephen Gilman, *Analyzing Financial Statements*.

6. *Mark-downs* to net sales. This ratio reflects merchandising ability.
7. *Returns and allowances* to net sales. This figure gives a clue as to the efficiency of the manufacturing or buying department as well as of the selling staff.
8. *Reorders* to new orders. This ratio indicates whether the management is emphasizing new sales at the possible expense of repeat sales.

The ratios of net sales to working capital, and to tangible net worth, indicate stress and strain from overtrading; if the ratio is too high, disaster may result from cancellation of orders, a sudden drop in new orders, a strike among employees—in fact, anything that interrupts the flow of money into the company from which current obligations must be met.

Table 96 illustrates the form in which some of the ratios may be set up for comparative purposes.

TABLE 96.—OPERATING FIGURES FOR SUCCESSFUL RETAIL STORES IN OREGON¹

Classification of items	Hard- ware, 27 stores	Drug, 38 stores	Men's clothing, 31 stores	Grocery, 39 stores	Jewelry, 30 stores	Shoe, 31 stores
Current ratios.....	4.6:1	9.0:1	3.9:1	3.4:1	4.0:1	3.7:1
Ratio of sales to mdee.....	2.9:1	3.2:1	2.8:1	11.6:1	1.5:1	2.6:1
No. days sales in mdee.....	108	98	111	27	208	120
Ratio of sales to receivables..	6.5:1	18.1:1	9.9:1	10.9:1	2.7:1	18.4:1
No. days sales in receivables..	48	17	32	29	116	17
Receivables per dollar of mdee.....	\$0.45	\$0.18	\$0.28	\$1.06	\$0.55	\$0.14
Sales per dollar of invest. in fixtures.....	\$18.81	\$9.80	\$18.00	\$29.32	\$10.84	\$18.04
Ratio of rent to sales	$\left[\begin{array}{c} 3.5\% \\ 12 \\ \text{stores} \end{array} \right]$	$\left[\begin{array}{c} 4.5\% \\ 16 \\ \text{stores} \end{array} \right]$	$\left[\begin{array}{c} 5.9\% \\ 17 \\ \text{stores} \end{array} \right]$	$\left[\begin{array}{c} 4.2\% \\ 12 \\ \text{stores} \end{array} \right]$	$\left[\begin{array}{c} 4.8\% \\ 9 \\ \text{stores} \end{array} \right]$	$\left[\begin{array}{c} 4.0\% \\ 15 \\ \text{stores} \end{array} \right]$

¹ RYERELL, O. K., "Financial and Operating Standards for Oregon Retail Concerns," *Univ. Ore. Studies in Business*, 2, October, 1929. These figures represent the performance of certain selected retail institutions. Only those concerns that might be regarded as "successful" were studied. The figures are not "representative" or "average" but indicate a goal which the "average" retailer might attempt to attain. It should be kept in mind that these figures would be different for the same type of store having different sales volume. This point is clearly demonstrated in the report.

The following figures indicate how the variation in the different operating factors stand out when several firms are compared according to a scientific method. These data are taken from an article published in the *Progressive Grocer*.¹ The operating expenses of twenty-five selected service combination stores for 1934 were analyzed.

Store No. 25 had the largest volume of sales; store No. 17 had the largest percentage gross margin to sales; store No. 18 had the largest expense percentage—this store had unusually high rent and delivery expenses; store No. 22 had the largest turnover rate; store No. 8 had the largest percentage of net profit to sales.

¹ Compiled from an article by C. W. Dipman, editor, pp. 42 ff., June, 1935.

It is interesting to note from these figures that the store with net sales less than half of those of the highest store enjoyed a total net profit almost as large and a net profit percentage almost two times as large. The large-volume store had a gross margin of approximately one and a half times that of the largest profit store. The store with the highest rate of turnover enjoyed a profit of only about 23 per cent of that of the highest-profit store, while the percentage of net profit to sales was only one-seventh that of the most profitable store. The relatively high margin was apparently the major contributing factor to the satisfactory accomplishment of this store, since its expense percentage was above the average and its rate of stock turn was about half that of the average. These figures clearly indicate the fallacy of following blindly any set of so-called *standards* of operation.

TABLE 97.—COMPARATIVE OPERATING STATISTICS FOR A SELECTED GROUP OF COMBINATION STORES

Stores	Sales	Gross margin	Total expenses	Net profit	No. of stock turns
Averages for group.....	\$49,166	\$9,656 19.6 %	\$8,217 16.7 %	\$1,439 2.9 %	19.2
Store No. 25.....	\$93,244	\$16,682 17.8 %	\$13,189 14.1 %	\$3,492 3.7 %	11.5
Store No. 17.....	\$47,809	\$12,210 25.5 %	\$10,210 20.1 %	\$2,000 5.4 %	10.2
Store No. 12.....	\$45,883	\$9,643 21.0 %	\$9,574 20.8 %	\$69 0.2 %	13.1
Store No. 22.....	\$75,376	\$12,142 16.1 %	\$11,426 15.1 %	\$715 1.0 %	41.1
Store No. 8.....	\$43,952	\$10,914 24.8 %	\$7,844 17.8 %	\$3,070 7.0 %	10.1

Table 98 illustrates the variations in gross margin, salaries and wages, occupancy costs, other expenses, total expenses, and net profits, that exist among seven different kinds of retail stores. Hardware stores, for example, had a gross margin of 31.80 per cent of sales, yet suffered a *loss* of 2.74 per cent; cash-and-carry groceries, on the other hand, had a gross margin of only 15.7 per cent, yet enjoyed a *profit* of 3.8 per cent. Variety stores secured the highest gross margin of the group, i.e., 33.84 per cent, but the net profit obtained was only 1.65 per cent.

Caution in Using Ratios.—An unbiased interpretation of the facts disclosed by the method of analysis outlined above will enable one definitely to locate the marketing difficulties of a firm. It is obvious that in a small retail business it is not practicable to work out all the ratios given, while in a large manufacturing, wholesaling, or retailing firm it may be found desirable to develop special ratios not here mentioned. This list is not intended to be exhaustive; it is given merely to suggest a line of attack.

TABLE 98.—OPERATING DATA OF RETAIL CONCERNS OF VARIOUS TYPES*
Expressed in percentages of sales

Operating item	Hardware†	Drug-stores‡	Service groceries§	Cash-and-carry groceries§	Combination food stores§	Chain groceries||	Variety stores¶
Gross margin.....	31.80		18.3	15.7	22.0	22.16	33.84
Salaries and wages	18.39	17.0	9.5	6.5	12.0	7.41	17.28
Occupancy cost...	6.94	4.0	3.8	2.8	3.6	2.47	8.35
Other expenses...	9.21	9.0	4.3	2.6	6.9	8.12	6.56
Total expenses.	34.54	30.0	17.6	11.9	22.5	18.00	32.19
Net profits.....	2.74**		0.7	3.8	0.5*	4.26	1.65

* Table taken from Cassady and Ostlund, "The Retail Distribution Structure of the Small City," *University of Minnesota Studies in Economics and Business*, No. 12, p. 85, 1935.

† Reports from eighty hardware stores in towns of from 3,500 to 10,000 population having sales of less than \$25,000 in 1933. Taken from the *Hardware Retailer*, July, 1934.

‡ Usual costs of a group of retail drugstores in cities of from 5,000 to 20,000 population having sales volume of from \$20,000 to \$30,000. From a survey made by Eli Lilly & Company of Indianapolis, for 1933.

§ Group of twenty-five selected stores from undesignated communities in 1932. Average sales of service groceries, \$52,000; of cash-and-carry groceries, \$79,500; and of combination food stores, \$108,300. From the *Progressive Grocer*, December, 1933.

|| Reports from combination and two exclusive chain grocery stores in the northwest for 1933. From private sources.

¶ Reports for 1933 of variety chains having an annual volume of less than \$500,000. From *Harvard University Bureau of Business Research*, Bull. No. 95.

** Loss.

It should be clearly understood that the specific figures used as a "standard" must be comparable with the figures representing the results being tested.

Operating ratios vary according to a number of factors. Thus the costs, net sales, and profits of the marketing department of a manufacturing concern are not comparable with the costs, net sales, and profits of a wholesale or of a retail concern. The costs, gross margin, and stock turn of a department store having sales of less than \$1,000,000 annually

are not comparable with one having yearly sales of \$30,000,000. The Harvard reports of 1935, analyzing operating results of department and of specialty stores, disclose, however, some unusual situations. The following quotation indicates the changing conditions.¹

The data for stores of different sizes since 1920, however, indicate:

1. That although the rate of net profit did tend to be directly proportionate to size from 1921 through 1932, there was a tendency also for the spread between the profit rates of small stores and large stores to narrow;
2. That this narrowing in the profit spread was due to a widening in spread between the typical total expense percentages for small and large stores;
3. That there was no discernible tendency for the gross margin spread to change; and
4. That these three tendencies apparently were interrupted during the years of decline, 1930, 1931, and 1932, but were resumed, perhaps with greater intensity, in 1933 and 1934.

The forces which have become active in the last two years have wiped out the difference in profit rates, and these now are about the same for stores of all sizes, the differences in margin and expense rates for small and large stores being about equal.

This fact gives rise to some very important questions, including the following:

Is this narrowing of the profit spread between small and large stores merely the result of forces connected with recovery or does it represent a permanent shift in relationships?²

What is the bearing of the N.R.A. and of other governmental recovery measures on this changing spread? Have these measures favored the smaller cities and towns, and hence the smaller stores?

What were the forces which, during the twenties, enabled large stores to earn at higher rates than small stores? Have these forces undergone permanent change?

Have there been changes in living and buying habits which have favored the smaller stores in outlying sections of cities, and in the smaller cities, at the expense of the large down-town department store? What are these changes, and how long will they persist? What is the bearing of traffic and transport conditions on these questions?

Do the relatively low margin rates of the smaller department stores constitute an advantage which the large stores should try to secure?

Has competition among the large down-town department stores, and between those stores and other distributors serving the same clientele, become more keen, so as to make for higher expense rates?

Possibly large department stores are now faced with a series of questions the answers to which will not be found in store operating results, or if found there will be found too late. The situation may well call for a thoroughgoing analysis of the demand for the sort of distribution services which department stores can

¹ *Harvard Bureau of Business Research, Bull. No. 96, pp. 4 ff.*

² "With reference to this question, it may be noted that the spread widened sharply in 1922 and again in 1931, one a year of recovery and one a year of decline."

over, and for such a readjustment in store policies and methods as may be indicated by such a study.

Location is another factor that must be similar, as is indicated in the quotation, if operating statistics are to be comparable. A business located in the down-town section of a city of 1,000,000 population is not comparable with a store located in the suburbs or in a small county seat. A firm that furnishes such services as credit, delivery, and a *quality* atmosphere will necessarily have higher costs than one operating on a cash-and-carry basis. There are other factors and conditions that must be considered in determining whether valid comparisons can be made. Some of the more important are the type and character of the product, type of clientele catered to, and the time element; that is, the season of the year and the period of the business cycle in which the statistics were taken must be given proper consideration.

The Difficulties Met in Establishing Standards.—While we do not have enough reliable information at present to set acceptable operating standards for all phases of marketing practice, it is possible to identify the factors that must be considered in such an attempt. The reports of the 1930 Census of Distribution and the 1933 Census of American Business furnish much valuable statistical information which may be used advantageously as a basis for evaluating marketing practices, organizations, and policies. Much more detailed information, however, is necessary before anything like reliable standards can be established.

There are definite factors and conditions that control, to a considerable extent, the volume of sales; prices that can be charged and paid; the kind of organization, methods, and policies adopted; gross margin, expenses, rate of stock turn, mark-downs, and net profits realized. The great number of variables affecting the results secured in marketing practice, however, makes the diagnosing and treating of marketing ills extremely difficult indeed.

Is There a Solution for the Marketing Problem?—Since, as we have learned in our previous discussions, costs of marketing are influenced (1) by the operating practices of producers, manufacturers, merchants, agents, and other marketing functionaries; (2) by governmental regulations, taxes, and other activities; (3) by the living habits, the consumption and buying behavior of consumers and other purchasers; and (4) by the policies and operations of our economic, social, and political systems, the possibility of securing lower marketing costs and lower prices depends, to a great extent, upon a more efficient operation on the part of the various marketing functionaries, a more enlightened attitude on the part of buyers, and a more intelligent policy on the part of our governments and their administrative agencies.

Costs of marketing and of production can be drastically cut if we are prepared and willing to *pay the price*. For example, production and marketing costs could be reduced through a thoroughgoing standardization and simplification of products, methods, and practices. To cite an extreme case: The population could be divided into several classes based on the nature of their occupations. Clothing and food could be standardized for each group, to the extent of providing uniforms. These could be produced in large quantities and distributed on a mass basis through a few large retail stores, strategically located, all other stores to be eliminated. This idea could be carried out with all necessary goods—all unnecessary goods, styles, grades, and so on to be eliminated; no individual choices allowed; duplication of factories and marketing agencies to be eliminated. All sales-promotional activities would be eliminated; only one choice would be offered as to quality and price; size would be the only variable. The cost of merchandise and services would be materially reduced, no doubt, but what would be the social and economic consequences? No one can answer this question in a truly definite manner. This plan we believe would not prove satisfactory in the long run to the American people or to any other civilized people. The history of the development of civilization indicates that such a plan is diametrically opposed to human nature and aspirations. There are opportunities, as indicated throughout our discussion, to secure reasonable and tolerable results without such drastic regimentation of the individual's economic and social activities.

Future Possibilities and Probabilities.—Producers, manufacturers, and merchants have come to realize, largely as a result of the depression of the thirties, that the consumer's purchases are limited by his income as well as by his desires. They have learned that a liberal supply of credit alone does not necessarily produce prosperity and a large volume of sales, and that high wage rates with part-time employment do not necessarily produce large and dependable purchasing power. A keen realization of the importance of the relationship between purchasing power and volume and quality of sales has led the alert management to make a critical study of economic principles. This type of leadership will become more interested in the problems of the distribution of income, the financing of consumer purchases, the regularization of employment, and the stabilization of industrial activities. There is likely to develop an insistent demand for a more conservative capitalization of industrial and commercial enterprises, a reasonably low but regular return on invested capital, and payments to labor and management in proportion to their usefulness.

The successful managements of tomorrow, it is hoped, will possess a clear understanding of marketing costs and will establish a firm control

over them. They will know that useless expenditures and uneconomic costs cannot be pyramided and nonchalantly passed on to the consumer. Reliable methods for anticipating future changes and determining significant trends will be developed. Marketing programs and practices will be planned and executed on the basis of carefully chosen facts. More attention will be given to determining what is wanted, and then, after the controlling factors have been given due consideration, steps will be taken to supply these wants by the most effective methods. Experimentation will be extensively used to determine better ways and means for attaining the objectives set up, and for testing proposed methods. Fantastic plans and high-pressure methods of sales promotion will have no place in the scientifically developed and operated marketing systems of the future.

Robots and other mechanical devices will be used to distribute standardized and well-known packaged goods in places where it is not economical or convenient to establish an elaborate sales place or to use salespeople. The telephone, radio, and the postal system will be used to reach dealers and consumers who are located far and wide, and whose purchases are too small to warrant the cost involved in using salesmen. A system of pricing based upon total unit cost will be developed. These new terms of sale will not penalize the buyer who is willing to pay cash and does not desire elaborate credit, delivery, and other forms of expensive services. It is to be expected that changes will be made continually in our marketing policies, methods, and organizations as they are adjusted to changing economic, social, and political conditions. The fallacy of trying to support the inefficient functionaries through the payment of subsidies in the form of artificially maintained high prices charged the masses will be recognized and abandoned.

Summary.—The general public and the business world are interested in the establishment of standards of performance for the marketing system as a whole, and for each individual firm performing marketing functions. The establishment of standards alone will not, however, produce efficient market practice. In addition to these standards, there is needed a *scientific method* of approach to the collection and study of marketing facts concerning the characteristics of the *demand*, the *product*, the *method of production*, and the *available agencies* for performing the services incident to buying and selling. The major objective of this method of analysis is to locate, identify, and evaluate those factors that determine the policies to pursue, the organization to develop, and the methods to follow in the efficient marketing of a given product or service. More satisfactory results will be secured when producers, manufacturers, and merchants learn how to adjust supply to demand, and to reduce such wasteful and unnecessary practices as handling unprofitable and

little-wanted items, soliciting unprofitable customers, striving for volume of business regardless of cost, and following uneconomic credit methods. Effective marketing, after all, is to be secured only through an adequate knowledge of demand, a wise choice of methods of distribution, and economical use of such factors as salesmen, advertising, display, terms of sale, services, and location.

Our discussion of marketing organization, principles, and policies clearly demonstrates that marketing is a major division of our industrial system. Modern economic life is much concerned with producing and distributing economic goods. Agriculture, manufacturing, mining, and the service industries are engaged primarily in producing *form* utility; our marketing functionaries are engaged primarily in producing *time, place, and possession* utilities. The creation of the latter group of utilities is just as essential in modern industrial life as the creation of form utility. Society has ceased to think of the merchant and the agent as non-producers—as parasites that “live on the fruits of other men’s labor.” One of the major problems of vital interest to the business man and to society is the development of more efficient marketing organizations, methods, and practices. Another problem that has recently come to the forefront is: What should be the relation of government to the marketing system and to the individual marketing institutions? There seems to be a general feeling that the governments and the marketing functionaries, each as a class, have a separate and distinct field of operation and influence, and that there is a third zone in which the operation and influence of each overlap. There is, however, no unanimity in belief as to the boundaries of the three zones.

5. "The extension of universally accepted standards of quality should go far to make marketing more efficient and less costly." Put content into this statement.

6. What, then, are the elements to be considered in determining the efficiency of our market organization, and of the particular institutions of which it is composed?

7. "More difficult of analysis but no less important is that group of problems which relates to the reaction of the existing market institutions, *mechanical and trade*, upon production and consumption." What is meant by the terms (a) "mechanical efficiency"; (b) "trade efficiency"? Explain the meaning of the quotation.

8. "I submit in all seriousness the proposition that it is not necessary for manufacturers to advertise in order to make human beings eat." Examine this statement critically. What is your answer?

9. "High-pressure stocking-up and high-pressure distribution by these manufacturers has reduced distribution to a state of anarchy, in which each factor in distribution is a law unto itself, and in which the general well-being of producers, distributors, and consumers is needlessly sacrificed." Give meaning to this quotation. What can and should be done about it?

10. "The cost of buying and selling and the overhead incidental to it, principally advertising, traveling, clerical, and office expenses, I shall call the cost of marketing." Does this statement include all the costs?

11. "The cost of transportation is obviously not a marketing or merchandising cost. Neither is the cost of warehousing, without regard to whether the expense for storage is incurred by manufacturer, wholesaler, or retailer." Do you agree with this statement? Justify your answer.

12. "That it should cost approximately an average of 63 cents of the consumer's dollar to distribute 37 cents' worth of corn flakes indicates a very definite need of an improvement in the processes of distribution." Examine this statement critically. How do you account for this "excess" cost?

13. "High cost of distribution is due to high freight rates, crosshauling, and unnecessary transportation; to 'high-pressure' selling, 'high-pressure' advertising, 'high-pressure' marketing generally." Do you agree? Defend your answer.

14. "There are two methods of measuring the costs of distribution." What are they? How reliable are they?

15. What factors determine the wholesaler's costs of doing business?

16. How may the efficiency of the individual marketer be measured? Be specific.

17. "What is the genesis of the mark-up? Why does the average grocer use a mark-up of 25 per cent; the average shoemaker and the average hardware dealer, a mark-up of 40 per cent; the average druggist and clothier a mark-up of 50 per cent; and the average furniture dealer and the average jeweler a mark-up of 100 per cent?" What factors should be considered in determining the mark-up policy?

18. What is meant by mark-downs? Why are they necessary? How may they be reduced?

19. "The public is primarily interested in the *gross profit* made by the merchant. The merchant on the other hand is primarily interested in the *net profit*." Define gross profit, net profit, and net worth as used in the merchandising business. Why is the public primarily interested in the gross profits and the merchant in net profits? What factors determine the amount of the gross profit; the net profit?

20. "The rapidity of the stock turn, or turnover, is an important barometer of good merchandising. It also serves as a means of comparison between departments, between different periods of time, between stores, and between lines of business. In it are seen the signs which point to the effectiveness or ineffectiveness of the buying

plan, the price plan, and the selling plan." Indicate how the turnover figure can show all these.

21. What causes a high rate of turnover? What are the causes of a low rate of turnover? How does the rate of turnover affect costs? profits?

22. How do the following factors affect the costs of marketing: the weather; size of order; number of buyers; location; advertising; "return privilege"; delivery service; taxes; standardization; number of "hands" through which the merchandise passes in reaching the consumer?

23. Indicate, by concrete examples, how the character of the product, method of production, personality of the producer, and the character of demand condition the methods of marketing. Be specific.

24. Some intelligent people believe that the solution of our marketing problems lies in one or more of the following: government regulation; ownership; or operation; or in "a planned economy." Indicate how marketing organizations, institutions, policies, and practices would be affected under each condition.

25. If we shifted from "owner-operated business" and "investor-owned and privately managed" industry to "government-owned and politically managed business and industry," how would marketing organizations, methods, policies, and practices be affected?

26. Collect marketing cost figures under the following headings:

I. Institutions:

1. Retailers—by various kinds, *e.g.*, grocery, drug, shoe stores.
2. Wholesalers—by kinds and volume of sales.
3. Producers—by kinds, location, volume of sales, and methods of distribution.

II. Commodities:

1. Agricultural products—by kinds, *e.g.*, hogs, wheat, milk, oranges, potatoes, etc.
2. Manufactured products—by kinds, *e.g.*, shoes, bread, men's hats, automobiles, paint, etc.
3. Natural products—by kinds, *e.g.*, coal, copper, petroleum, building stone, fish, natural gas, etc.
4. Services—by kinds, *e.g.*, electricity used in the home, by industry; various forms of transportation services, etc.

What are some of the major factors that affect the costs of operation in each instance?

Assignment

1. Problem 1, p. 499. Rolland Department Store—Merchandise Control (Review).

2. Problem 2, p. 135. Cleland Company—Gross Margins.

3. Problem 2, p. 534. Glendale Company—Returned Goods.

4. Problem 1, p. 532. Bolton Equipment Company—Returned Goods.

5. Problem 1, p. 404. Tarpon Company—Sales Control.

6. Problem 2, p. 464. Hamerton Company—Selection of Customers.

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